SOCIO-LEGAL DISSECTIONS OF GUARANTEES-COMMERCIAL AND NON-COMMERCIAL INCLUDING BANK GUARANTEES AND JUDICIAL TRENDS

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CERTIFICATE

Certified that Mr. Mohd. Akram Mir, Lecturer in Law, University of Kashmir, Srinagar, has worked under my supervision for his Ph.D. degree on "Socio-Legal Dissections of Guarantees -- Commercial and Non- Commercial including Bank Guarantees and Judicial Trends". The study is an original contribution in the field of law relating to Guarantees.

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CHAPTER - I

INTRODUCTION

The distinctive feature of Contract Law, as compared to other branches of law, is that in the former the parties make law for themselves within the broad framework of the Contract Law. The fact that the State is willing to deploy its coercive apparatus to protect the reasonable expectations of promises means that the contracting parties are enabled to acquire a kind of "limited sovereignty" by virtue of which they can engage in "private legislation". The importance of contract in regulating business and other social and economic relations is so great that not only private enterprise, but public enterprise units and the Government have resorted to contract as an instrument of participating in their country's market economy. Contract is,in effect, the instrument by which the conflicting interests of the participants in the economic process can be reconciled and brought to a common goal.

"Pacta Sunt Servanda" (agreements are intended to be performed) once the pivotal of contractual jurisprudence has now fallen into notoriety due to breaches of holy pacts, search for elusive defences by interested parties, hedges in performance evolved by law. The shrine having dwindled in course of centuries among other things due to people's low morale, culture, habit and discipline, the contracting parties now salvage or strengthen their legal position by a third party, called the surety.

When the Indian Contract Act, 1872 was brought on the anvil, it was thought and rightly so, to include a chapter on indemnity and guarantee. In course of over a century the concept has found multiple uses in myriad factual situations. These situations are not necessarily of a commercial nature. They encampass within their orbit situations as to repayment of loans and Bank overdrafts, repayment of the price of goods, sold to the principal debtor, guarantee to and by the banks, guarantees as to the regular payment of rent and fidelity bond of an employee relating to the honest discharge of his duties and partnership ventures etc.

The guarantee agreement has earned its rightful place as an important component of the commercial loan transactions. The immediate access to guarantors makes credit available in cases where it might otherwise be denied.

A guarantee is the simplest form of security as banker may take and is for that reason the most common. Except where it is desirable for the banker to invite the guarantor to take independent advice, no formalities are required apart from obtaining the guarantor's signature on the bank's standard form of guarantee. A guarantee is not a particularly safe form of security-depending as it does on the guarantor's willingness and ability to pay when called upon to do so. A guarantee often demanded by a banker as an additional security to reinforce a clean advance or buttress a tangible security.

With respect to the undertaking by the surety, the types of guarantees are those guaranteeing the honesty of and faithful performance of duty, by, the principals, such as public officials and court fiduciaries; those guaranteeing the credit of the principals; such as agents, consignees or licenses receiving money or property for which they are required to account; those guaranteeing the immediate payment of money or delivery of goods upon the happening of a specified contingency, such as the result of an appeal; and those guaranteeing the performance of contracts, such as for construction work and the supply of materials.

First, there are public official bonds also called official undertakings. These are written by a surety to guarantee in effect that a named public official will faithfully discharge the duties of his office and promptly account for and pay over all money or properties received by him as such officer. Treasurers, customs and revenue officers, tax collectors and many executive and administrative officers fall in this category.

A second important class consists of fiduciary probate bonds. These are given to assure that the principals will faithfully administer and account for the assets er estate. With which they are entrusted. In this group are executors, administrators, trustees, guardians, committees, assignees and receivers. They hold office by court appointment.

The next class of bonds and that constitutes the most considerable portion of the business of suretyship is composed of those guarantees such as constructions contract bonds, these cover public works, high ways and tunnels, docks and drainage, public building and private construction of an almost unlimited nature. The surety undertakes in general, to indemnify the creditor by assuring the completion of the work, payment for labour and materials and indemnity for loss through injury to workmen or defective construction.

The concept has found an in let into the educational environment also. Some universities while granting study leave to their teachers require them to fill a bond to serve the university for a stated period on their return from the leave. This is required to be backed by a local guarantor so that in case the teachers (principal debtors) fail to return to their or fail to fulfill the terms of the contract, the surety could be made liable by the educational institution to perform his part of the contract. Again, students, many of them minors, are admitted to the Engineering and Medical Courses under a guarantee by their guardians that on passing the prescribed examinations the words shall serve at the place/places concerned for a stated period, otherwise the surety shall be liable. The credit houses which deliver goods on credit or on instalment to customers not unoften make use of the instrumentality of the guarantee, especially when the customer is non-government servant.

Banking system occupies a very important place in the economy of the modern world. The banking industry in India at present is passing through a period of rapid development and radical changes. It can hardly be gainsaid that banks have a pivotal role in financing the economic development of the country, their object inter alia being to promote production eradicate poverty and unemployment, and to encourage the full development of the productive resources of the country. In conformity with these objectives, the banks have been called upon these days to extend direct and indirect industrial and agricultural credit, besides giving direct financial assistance to carry out the developmental activities of the State. The development of banking has reached a stage where the banks are required to identify their business with national policies and programmes.

In India, until recently, business on a large scale was confined to a few large cities. With an accelerated process of development, the variety and magnitude of commercial activities have expanded. Large scale construction and collaboration contracts involving huge financial outlays have naturally increased the need of taking guarantees from banks, mostly for tenders and performance.

The purposes of guarantees by banks are many. These include performance of a contract, repayment of a loan, repayment of an advance payment made in respect of a contract involving the sale of goods and so on. The undoubted value of a guarantee on behalf of a customer is becoming an increasing practical advantage to commerce. In practice the banker who gives the guarantee takes from the customer what in fact, is a counter indemnity, usually indicating that he is to pay on first demand.

At the present time perhaps the most important ancillary service rendered by a banker to his commercial customer is the facility of credit which enable the customer to discharge his obligations. The main feature of this, however, is that the banker through his business connections is able to place the machinery of international commercial banking at his customer's disposal. Bank guarantees in internal and international trade are common features of commercial practice. Transactions involving financial liabilities of some magnitude are now almost invariably accompanied by bank guarantees.

Since the advent of freedom in India an adoption of industrial resolution and plan projects by it, the system of guaranteeship has taken a new turn, the export and import of trade, spreading of business within the country and punctilious performance of contract have, really speaking, necessiated the use of the instrument, foreign businessmen and country which enter into trade pacts with Indian commercial concerns require the guarantee by the State Trading Corporation of India or some allied agency to avoid a situation of dispair and dispute. Banks equally play an important role in furthering the cause of the trade through their guarantees. It has rightly been observed:

> The bank guarantee is an important instrument in internal trade of a country, sometimes it also plays a useful role in international trade,

> a letter of credit is important in international trade. Obligations in bank guarantee is not an unqualified obligation. By an irrevocable letter of credit, on the other hand, the issuing bank gives an undertaking to the beneficiary that all bills drawn in terms of letter of credit will be honoured without qualification.[1]

It would also be useful to refer to the Agricultural Credit Society Act, 1968, where loans are given for Agricultural purposes, the security for recovering the loan would obviously arise and the guarantee by a third person would secure the loan advanced to a farmer under this Act, 1960. Interestingly Chapter 10 which deals with Land Development Banks makes use of guarantee by the Government under sections 74 and 75 of the Act. Sections 29 and 30 respectively of the Indian Co-operative Societies Act, 1912, also deal with loan by or to a registered society. But unlike the Jammu & Kashmir Act, there is no mention of guarantee either in these or other sections of the Indian Act. However, recourse to the guarantee is not eliminated and the general principles of law will apply.

Deposits collected from lakhs of people were distributed among privileged few. The social wealth of the nation became the closed-door strong room of the rich. The common man, the farmer, the small industrialist or the small businessman the type of people who make up the vast majority of India -were more or less denied an entry into this exclusive club of the elite - a faction that appropriated a lion's share of the national wealth and bank credit. Therefore, the financially uncared for people had to throw themselves into the arms of the traditional moneylender to whose clutuches once most of the Indian rural masses were bound. On the other hand, institutional finance continued to be at the back and call of the industrialists, big land-lords and speculators. If anything, this pattern of finance served to defeat an impbrtant socialistic objective of the Five Year Plans,i.e. reducing the economic disparity among the Indian people and in different areas.

The neglect by the financial institutions was not limited to the weaker sections to whom money at reasonable rate of interest and in the simplest form of security was almost like Life saving drugs. Some changes in this one sided finance lending story was interjected in 1967 when the social control scheme was introduced.

It is worthwhile to mention here that since the Nationalisation of the banks it has become easier for the government to implement its social welfare programmes by directing the banks to grant easy loans to small scale industrialists and others. To provide adequate safeguards to such lending banks, the government has constituted a deposit insurance and credit guarantee Corporation of India.

In every developing country credit system, backed by guarantees and securities plays an important part. This helps the individuals in the raising of their living standard and capabilities for advancement. Firms and Companies also are benefited in the expansion of their activities concerning trade and commerce. The two main agencies for showering financial benefits for advancement and development are state financial corporations throughout the country and the banks. An inquiry into the office of Jammu and Kashmir State Financial Corporation reveals that loans against guarantees, mortgage/ hypothecation are granted by it for the following purposes:

i) Weaving on Handlooms

ii) Weaving on power looms

iii) Stone crushing

iv) Drug Manufacturing

v) Cold storage

vi) Printing press

vii) Husking of paddy

viii) Band Saw Units/Saw Mills

ix) Flour and Rice Mills

x) Milk products

xi) Poultry and Cattle feed

xii) James,Jellies, pickles etc. [2]

All this is possible both through the system of guarantee and securities which borrower gives to the Corporation as per details prescribed by the Corporation.

The banks also have come forward particularly since the time of Nationalisation in fulfilling the objects of the Five Year Plans to expand Commercial activities and provide relief to unemployed. A look at the report of the banks that a huge amount is advanced to the needy persons. What is intended to be emphasised here is the increasing importance of the instrumentality of guaranteeship and other forms of securities which has kept the "credit Ball in Motion". All this has been highlighted at appropriate places during the course of the research work.

It will thus be seen that both in internal and international trade and maney other matters the modality of a guarantee has become indispensable.

Purpose and Scope

During the course of more than a century of the Indian Contract Act, many legal problems have arisen which find no clear answer within the provisions of the Act. The courts have, therefore, grappled with these new situations, sometimes on the basis of the provisions, sometimes on English Common Law and sometimes on their judicial wisdom and experience. And yet, all this is not over !

The glimpses of some of these problems which will be high lighted in this thesis in different chapters are as follows:

a) The question whether or not a memorandum between parties is a contract of guarantee has arisen in many cases. A mere introduction or recommendation by the landlord of his new tenant to the Shopkeeper in the locality is not a guarantee that the former stands a surety to the latter for the payment of goods sold on credit to the tenant. On the otherhand, a positive assertion in writing as follows:

> "There will be no trouble in the payment of your money. Be assured if thereby any trouble, I hold myself responsible," has been held a surety contract.[3]

Again the question has been mooted whether a contract of guarantee is a Contract Uberrimae Fidei, according to Trietle,[4] Contracts of suretyship or guarantees are sometimes said to be Uberrimae Fidei, but the later view is that they do not fall into this category. According to Tennan also whether or not a contract of guarantee is one known to lawyers as uberrimae Fidei, that is one in the carrying out of which utmost goodfaith must prevail has been stumbling blow even to classical legal authorities.[5]

The Indian Courts, not often, were called upon to examine this problem. In one case, however the Indian Court repudiated any similarity on this point between a contract of insurance and a contract of guarantee - The former belonging to the class of uberrimae Fidei and the later not. The later class of contract were called "Strictasscina Juris".[6]

The legal distinction which emanates from this aforesaid classification is vital. In insurance cases there is a heavy duty to disclose and non-disclosure may be so sensitive that it might not only render the policy void but also debar the representatives of the policy-holder from claiming even the refund of the premiums paid by the deceased on such a defective life policy[7]. In the suretyship contracts not classified as Contracts Uberrimae Fidei there is no such heavy duty of disclosure on the part of the creditor. Due to the importance of this legal position the thesis will undertake an in-depth study of the whole matter.

b) Again a surety has been called a favoured debtor. Why? firstly, his liability is secondary and not primary, because it arises in the case of principal debtors default under section 126, Second, if the acts of the company for which the debts have been guaranteed are ultra-vires the memorandum of association, the surety obviously, will not be liable for these illegal debts.[8] Thirdly, his principal debtor under section 128, Fourthly, he is entitled to reimbursement from the debtor upon payment and also entitled to securities in the hands of the creditor. In <u>State of Maharashtra v. M.N. Kaul</u>,[9] Hadayatullah, C.J., pointed out that the dictum that a surety is a favoured debtor has been accepted both by the Privy Council and the Supreme Court but what is vital for the purpose of the thesis is the observation of the learned Chief Justice in that case that the course of legal events have evolved several exceptions to this rule or status of the surety as a "favoured debtor". The thesis has explored this vital aspect of law.

c) Section 129 of the Indian Contract Act defines as to what is "continuing guarantee". The actual definition is beset with legal difficulties. Questions have arisen whether the guarantee of a fidelity bond, due and regular payment of instalments of licence money are in the nature of a continuing guarantee. Further, a Rangoon case[10] has held that the illustration"a" to section 129 does not lay down a correct statement of law. Is it so? if so, why? The whole distinction between an ordinary and fixed guarantee is meaningful. If the former, the revocation of the guarantee is a breach of contract. If the latter, the guarantee can be revoked under sections 130 and 131 of the Contract Act and thus, the surety is further favoured at law. The thesis has examined this problem and attempted to determine whether the definition of the continuing guarantee is satisfactory or needs change.

d) The minor's agreements have been held to be void by the Privy Council in Mohri Bibi v. Dhurmodas Ghose.[11] The chapter on guarantees, however, is absolutely silent as to and whether a guarantee as to the payment of debts incurred for necessary or non-necessary purposes by the minor is valid or not. Section 128 of the Contract Act only speaks of the co-extensiveness of the guarantors liability. The Indian Courts have been divided over this question and both opinions, affirmative and negative have been expressed. The thesis has further, considered this problem, in the light of English Common law in practice.

e) In quite recent years- the performance guarantees have raised a new dimensional problem, the problem has arisen out of standard form contracts where one party binds the bank to pay the money to the creditor within a specified period demanded by him irrespective of the existence or non-existence of a dispute. The judicial attitude of the Supreme Court in M.S.E.B. Bombay v. Official Liquidator, H.C. Ernakulam,[12] and of the Delhi

High Court in cases held earlier to this case (Pesticides India v. S.C. and P. Corporation of India,[13] and M/s B.L.R. v. Pos Cooperative Society and M. Federation Limited,[14] and other have been favoureble to the creditor and unless it is a case of fraud it appears, the bank will not be stayed to deliver the money or perform its guarantee to the creditor. In England, where the same result prevails Lord Deuning has liked the performance guarantee by banks with irrevocable letter of credit".

This problem, however, is not easy under the guise of development of trade and commerce courts have become champions of one-sided clauses, which is another grab of the condemned exemption clause in the field of the law of contracts. The matter is serious and the researcher has attempted a thorough probe.

d) Yet another area, significantly important, is the questionable power of the parties to make the provisions of the Contract Act (Chapter on guarantee) subject to the will of the contract. Can the parties abrogate the legislative will and substitute it with their own? If the answer is in the affirmative, careful draftsmanship of a party will, doubtless make him victorious in Courts and will restrict the task of the courts to a mere construction of the deed. The thesis has examined this problem.

These are only some of the problems which will be dealt with in the thesis. Other important matters on the subject will also be discussed. It needs to be clearly spelt out that the thesis will not be complete without the delebration of the topic of "Bank Guarantees" including performance guarantees by banks) through questionnaire and interviews. Thus the methodology of research will not be restricted to study and dissection of the judicial decisions alone. It emperical knowledge gained through issue of Bank questionnaire and interviews. Research cards system has been followed. The recommendations of the Law Commission in their 13th report have been discussed where-ever found.

The thesis most primarily deals with the indian situations, the indian provisions and the indian judicial decisions. It shall in no sense be comparative with English law, although Sir F. Pollock in his preface to the indian work on Contract Act pointed out in the opening sentence that this Act is a code of English Law,[15] nevertheless, as the majority of the Supreme Court in Girdhar Lal v. Bhagwan Dass,[16] pointed out that the Indian Contract Act is exhaustive and in such cases principles of justice, equity and food conscience will be applied which means English law, except where indian considerations and circumstances are different. But the Indian Contract Act is exhaustive so far as it goes and it is not permissible for the Indian Courts to apply the principles of English Law de-hors the Indian Act, as was pointed out by Justice Mukerjee in Satysbrata Ghose v. Mugneeram,[17] the reference to the English decisions will, therefore, be not frequent but only occasional i.e. when in the fitness of a thorough research or a new situation reference becomes desirable.

Nor shall this thesis make a detailed study of the bond given by a person to the Court strictly speaking, such a bond falls outside the scope a bond falls outside the scope of Contract of guarantee under section 126 of the Contract Act. But the Court may apply the spirit of these rules whenever a question relating to the discharge of a surety is involved.[18]

The reasons for picking up of the topic for academic explusion are now, indeed obvious. These reasons are mani-fold. Firstly the concept of the suretyship is age-old, however, no scholarly significant contribution has been done in this area. In otherwords the topic is like the trusty version land in the desert and any probe in its disection will, undoubtedly convert the desert in an oasis.

(i) The concept of suretyship is developing concept in the Industrialised india of today. New situations are coming up before the courts and the courts are combating with these problems. Sometimes on the basis of interpretions of the relevant provisions of the Act, sometimes on guidance from the English Common Law System and sometimes as a result of their judicial widdom, experience and insight. However, all the problems which have arisen before the courts have not yet found satisfactory solution. The foregoing pages demonstrate that in some situations there are differences between the courts. Neither the matter has reached to the open court of the land, nor has the legislature given it a magic touch with the result that the problem continue to lie where it was. It is significant, therefore, that an earnest effort must be made to find out satisfactory solution so that the law has a smooth functioning and it achieves, what jurisprudents say that certainty is one of the hall-marks of a good law.

iii) The concept of the suretyship has broken national barriers. It has also become the forecry of international trade. International communities are coming up closer and india like some other countries thought of to reverse its advance balance of trade with the countries concerned. Naturally, therefore, the countries intending to enlarge their trade with India will be happy if the punctilious performance of the contracts in the quality of the goods are assured by the Government of India or by any of its allied agencies when the private sector contracts to supply the goods to the foreign trading community. Fundamentally for this reason alone the National and International sphere cannot be ignored and the law relating to the guarantee must find any adequate place in any research programme in this country.

iv) The Indian Contract Act was brought on the Statute Book in the Year 1872. In the year 1955, however, a law commission was set up to suggest suitable changes in this Act. The commission in their 13th report have not suggested significant changes in the concept of Guaranteeship, nevertheless the Law commission made recommendations in the definition of indemnity. The thesis, therefore, makes some suggestions for changes in the provisions on the chapter of guarantee. These changes for law reform may be kept in view in any future revision of the Act. Lastly the concept of the suretyship is a simple instrument as against a variety of concepts like mortgage, pledge, hypothecation which also secure in advance the future performance of the contract by the promisor. However, these concepts do not involve third parties and are necessarily complieated. In case of a contract of guarantee, here the principal-debtor does not part with anything of value nor does the surety immediately handover the money, although he puts himself under a bond of obligation to the creditor in case of the default of the principal debtor. A creditor may involve, particularly where the financial risks are high, both a guarantee by one or more persons and pledge also by the principal debtor if possible.

Under the system of suretyship the creditor is safe even if the principal debtor becomes insolvent and various complications of law and procedure are abated when the principal debtor dies. The thesis brings out the value of the growing number of contract of guarantees in a developing society like India.

The study does not go into the question of procedure, proof and evidence, stamp duty and suit valuation as these are more important for practising lawyers.

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CHAPTER - II

NATURE AND ESSENTIALS OF THE CONTRACT OF GUARANTEE

History of Guarantee

A contract of suretyship is one whereby one party, the surety, guarantees that the other party, the principal debtor, will perform or carryout a contract or obligation with a third party, the creditor or obligee.

The contract of guarantee is of very ancient date, perhaps to be "Coeval with the first contracts recorded in history". It seems that the words warranty and guaranty[1] were the same, the letter 'g' of the Norman French being convertible with 'w' of the German and English, as in the names William or Guillaume.[2] They are sometimes used indiscriminately, but in general, warranty is applied to a contract as to title, quality or quantity of a thing sold[3] and guarantee is held to be the contract by which one person is bound to other for the due fulfilment of a promise or engagement of a third party.

Guarantee is the Low Latin guarantia or garantia, which is merely a variant spelling of warrantia. Ultimately the word is Teutonic, and means "protect", "defend" and the like (Germwehren) a meaning which remained its exclusive sense for a long while.[4] The legal use, however, is Later. The Statute of Frauds, which describes, what we call a guaranty, calls it, " a special promise to answer for the debt, etc. of another".

The word "surety" has an unbroken lineage which is far older. It is the Latin securitas, perfectly classical in its obvious sense of freedom from anxiety or fear. This literary sense is also the legal sense. The more special sense of discharge from an obligation is at least as old as Gauis (Circ. 160 A.D.)

Then in Medieval Latin we find it employed of the person who signs the bond as additional obligor and not of the bond itself. This shift must have taken place early enough since in Medieval French, seurte is used both for a person and for the contract. So, far example, in 1273-1280, in Register des Faides de waurnai, we read, "raporta as provos et as Juses Le seurlet firne et estnle', which seems to be the document itself, while in a book of the 18th Century, the Coutume des francs hommes de cambrai, it is the obligation.[5] In many of the instances it is difficult to tell whether it is the person or the contract which is called by that name, but it is evident that the shift must have been an easy one and that it became established very early. When the word was taken into early English, a new word, suretiship, was coined by those who had forgotten that securitos was itself an abstract.

The concept of suretyship has existed from the earliest days of mankind. It originated in the man or tribe or nation to whom an obligation was promised or due holding a certain man as 'hostage' for the performance of that obligation. To secure performance of the promise or obligation, a hostage was given. Originally the surety relation was actually one of personal security, the surety being little more than a hostage subject to imprisonment and sometimes death upon the default of his principal.[6] In the thirteenth and fourteenth centuries, the surety no longer paid with his body, but his liability was translated into money and enforced in an action of debt.[7]

At common Law it is not likely that we should find any differences in the relations expressed at the present day by suretyship and guaranty. When guarantee and guarantor do appear, no attempt whatever is made to differentiate them from the already existing expressions. English cyclopedias do not recognize any distinction. Halsbury's Law of England,[8] treats of the subject only under the term guarantee and identifies the surety and guarantor. In a broad sense a contract of guarantee corresponds with that of suretyship, the distinction between them being merely technical, and a transaction which is called in some cases an absolute guarantee is demoninated by other courts a contract of suretyship. A guarantee is like a suretyship in the sense that it is an engagement to answer for the debt, default or miscarriage of another and for this reason the term 'surety' and ' guarantor or guarantee' are often confounded and used interchangeably.

As far as the cases are concerned, there is equally no sign that the courts in England during the nineteenth century were aware of any attempt in practice or in law to distinguish between an agreement to be a surety and to be a guarantee.

When and how did the notion originate that a guarantee was in some way different from a contract of suretyship. We have seen that the common law knew nothing of it and that the English Courts continue to know nothing of it. It is evidently in American courts somewhere that it arose, since it is found only there.

In Oxford Bank v. Haynes,[9] it is said:

> " A guarantee differs in character from a surety, cannot be questioned, for he cannot be sued as a promisor, as the surety may, his contract must be specifically set-forth. That he differs from an indorser is equally clear and for the same and also because he warrants the solvency of the promisor which the indorser does not".

It is conceded that the guarantor ought to pay only if payment cannot be made out of the principal debtor. The surety is to pay whether the principal can or cannot. In other words, we have in germ the phrase which was later to have such success in discriminating the two contracts; the phrase that the surety promises to pay if the principal does not, the guarantor, if he cannot. To this we must add the case[10] in which the court sets forth the true distinction, which is that the surety is liable for the debt and the guarantor only where default is made by the principal debtor, and that the surety is bound by a specialty, the guarantor by a simple contract. A surety promises to do the something which the principal undertakes; the guarantor promises that the principal will perform his agreement and if he does not, he, the guarantor will do it for him. The liability of the surety is immediate and direct. He agrees that he will perform the principal contract, fixing upon himself the responsibility from the beginning. Both the surety and guarantor agree to pay the debt of another, but the liability to pay in the case of the surety starts with the agreement, whereas, the liability of the guarantor does not start with the agreement and is established for the first time by the default.

The contract of surety is made at the sometime and usually jointly with that of his principal, while that of the guarantor is a contract separate and distinct from that of his principal. It may be made at the same time and upon the consideration.[11] The contract of surety is a direct original contract with the obligee, that the very thing contracted should be done. Whereas a guarantor enters into a cumulative collateral engagement by which he agrees that his principal is liable to and will perform a contract which he has made or is about to make and that if he defaults the guarantor will upon being notified by the resulting damages.

What is more original about the surety's contract than about the guarantor's - or more direct ? In either case he either did or did not make the promise and we must took his words and conduct to determine whether he did obligate himself and to what extent. Just as we must in the case of principal debtor. In one sense both promises are absolute. Both promises undertake that the creditor shall receive the performance to which his claim entitles him.

We may illustrate by the two persons who are concededly most alike, and yet are declared to be in some mystical way wholly different, the absolute guarantor for payment and the surety. It is said that the surety owes the amount of the bond just as well, as the principal. The principals default is his default. The guarantor's obligation on the contrary is not fixed until and unless the principal defaults. The guarantor's default does not begin until after the principal has defaulted. But will this stand examination? Default creats a cause of action. It is obvious that the creditor cannot sue the surety until the day after performance is due and on the same day and not before, he can sue the guarantor. If the principal performs neither surety nor guarantor is liable.[12]

The difference consequently is neither substantial nor even formal but merely verbal. Shall we leave it there and assert with solemnity that we should hold men to their words and that they are guarantors when they say they due and sureties when they call themselves so? It may be said that no test has been more uniformly rejected than this one. We should be indulging in the absurd fiction that the businessmen knew the full legal implications of words which lawyers and courts have not succeeded in defining, and we should be introducing regidity of interpretation in contracts which more than others, call for freedom and flexibility.

The distinction so widely insisted upon and from which serious consequences are drawn, is no better grounded. It has no roots in the past. It has no sense in the present. If it is disregarded it will clear the subject of a portentous amount of confused phrases and economise effort in investigating, besides avoiding the obvious injustice of refusing or granting relief on so insubstantial a basis.

Definition of Guarantee

A guarantee often demanded by a banker as an additional security to reinforce a clean advance, or buttress a tangible security, which for one reason or the other is not considered adequate.

The term guarantee or guaranty as it is called by some authorities is a collateral promise or undertaking by one person to another to answer for the payment of some debt or the performance of some contract or duty in case of the default of another person, who in the first instance is liable for such payment or performance.[13]

Halsbury defines guarantee as an accessory contract, whereby the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person, whose primary liability to the promisee must exist or be contemplated.[14]

Some of the common law rules with respect to suretyship were, for the first time given statutory basis through the English statute of Frauds, 1677. The pre-statute law did not require any written evidence of a suretyship which could thus be proved in the same manner as any ordinary contract. The main purpose of the statute of frauds was to prevent the danger of suretyship being established through false evidence, or by evidence of loose talk, when it was never meant really to make such a contract.[15]

Under Statute of Frauds a guarantee is a special promise to answer for the debt, default or miscarriage of another person. These three words point to three distinct kinds of guarantee,[16] namely, (1) guarantees for the payment of a debt already contracted by another person. (2) Guarantees against the default of another person, i.e. for the payment of debts to be contracted by another person, or against loss that may occur from another's future breaches of duty and (3) guarantees against loss that may arise out of another's past or future breaches of duty.

An obvious difficulty is the significance of the three terms, debt, default, miscarriage, unless they are synonymous. The question was raised in 1819 in <u>Kirkhan</u> v. <u>Martee</u>,[17]

> The defendants son had without the plaintiffs permission, ridden the plaintiff's horse and killed him, and he was therefore guilty of a tort against the plaintiff. The plaintiff threatened to sue him, and in consequences of the threat, the defendant orally promised the plaintiff to pay to him the agreed value of the horse of the plaintiff would forbear his suit.

The defendants when sued on this promise pleaded the statute of frauds and the plaintiff argued that the Statute applied only when the liability guaranteed arose out of a pre-existent debt. The argument was rejected chief justice Abbott said:

> "The word miscarriage has not the same meaning as the words default or 'debt'. It seems to me to comprehend that species of wrongful act for the consequences of which the law would make the party civilly responsible".18

The words of the statute were not confined to the cases of the contract, and, as the son has been guilty of the tort for which he might be sued, the father's undertaking was a promise to answer for the miscarriage of another person. It would seen, therefore, that the guarantee in the case of a contractual liability is covered by the word debt and, perhaps, by that of default and the guarantee of a tortious liability by the miscarriage.[19]

The conclusion may be accepted as a reasonable interpretation of the terms which had no precise legal meaning.

It is not necessary here to attempt an exact definition of the word 'debt', in as much as the three terms debt, default or miscarriage have been held to include all legal obligations under which a person can come, contractual or non-contractual, requiring a money payment or any kind of performance. A person may be indebted without being in default or having committed a miscarriage of duty. These two terms were added to the statute so as to make perfectly clear that it includes promises to answer for another persons breaches of duty of all kinds as well as for his unmatured debts.[20]

The restatement of security uses the words "surety" and "guaranty" interchangeably as synonymus even though the word surety was designed to characterize a primary obligation while the word guaranty was designed to characterize a secondary obligation.[21] The restatement attempts to define the suretyship as:[22]

> "Suretyship is the relation which exists when one person has undertaken an obligation and another person is also under an obligation or other duty to the obligee. Who is entitled to one performance of the obligation of another and as between the two are bound. One rather than the other should perform".

The suretyship relation exists where one undertakes an obligation and another is under obligation or duty to the obligee, who is entitled to one performance, but as between the two who are bound, one should bear the burden of performing. Whether one is a surety, therefore, depends not upon his relation to the obligee, the creditor, but upon his relation to the principal obligor, the debtor.[23]

<u>Indian Position</u>

The Indian Contract Act, 1872 appears to follow the general Anglo-Saxon pattern in respect of the rules governing the contractual relationship arising out of a contract of guarantee. However, it is important to bear in mind that although the relevant provisions of the Indian Contract Act partake of English Law in many material particulars, yet there are some significant differences between the two.

The definitions, of the 'surety', the 'principal debtor', and the 'creditor', rightly find place in section 126 of the Indian Contract Act . The section as a whole convey the general idea of what a contract of guarantee is, and who are the actors in the transaction.

The contract of guarantee is a credit device that make its appearance with earliest development of business obligations. Under the terms of guarantee agreement, one party becomes answerable to a third party for the acts or neglect of a second party. The surety is a person who gives the guarantee. The person in respect of whose default the guarantee is given is principal debtor. The creditor is the person to whom guarantee is given. A contract of guarantee pre-supposes three parties. First of all there is a contract between the principal debtor and the creditor. It may be said to be the base of the entire transaction. Then there must be a contract between the surety and the creditor by which the former guarantees the debt to the latter. This, however, is not enough to constitute a contract of guarantee, because so far, one essential element is still missing, and that further element is that there must be a contract by which the principal debtor asks the surety to act as such though such a request need not always be express and may be implied.[24] Untill this whole chain is complete, a contract of guarantee as contemplated in the Indian law of contracts does not come into play. The reason is that until there is privity of contract between the three respective parties, it will not be possible, to work out the rights and liabilities of the surety and the principal debtor. In other words, if a person undertakes to reimburse another for some loss which may be caused to him, say by a third party or by himself without the express or implied request of a third party. The person having undertaken the liability and having been called upon to make good the loss would not be able to recover the loss so caused to him from the principal debtor the latter being not a privy but virtually a stranger to the undertaking given to the promisee. In Periyamianna Masakkayar and Son v. Baniars & Co.,[25] it was observed by Krishna J.

"though section 126 of the Act does not expressly say that the debtor should be a party to the contract, it is clearly implied, taken with other provisions of the Act as Section 145 that in every such contract, the debtor must be a party".

This however does not mean that such triportite transaction should be embodied in a single document and it is quite possible, as is often the case, that the transaction between creditor and the debtor and that between creditor and the surety are embodied into two separate documents. In Prasanjit Mahtha v. United Commercial Bank Ltd.,[26] the suretyship agreement was executed between the creditor and the surety and principal debtor was not made a party to it. It was, therefore, contended that it was not a valid contract of guarantee. The court rejected the contention as misconceived, for her the cash credit facility was extended by the creditor bank to the debtor private Co. upon the directors and principal officer guaranteeing repayment and it is not necessary that this triportite transaction should be embodied in one composite document making the creditor, debtor and surety parties to it.

There can be no contract of guarantee if the liability does not exist. The liability of the guarantor presupposes the existence of a separate liability of the principal debtor and his liability is thus secondary, which comes into existence only in default by the principal debtor.[27] To the same effect is the decision of Calcutta High Court.[28] The issue in this case was whether a guarantee amounts to a promissory note or not. The words ' promise to pay' may mean a promissory note under the Negotiable Instruments Act. A promissory Note means an unconditional undertaking signed by the maker to pay a certain sum of money. But in this case, the guarantee agreement is alleged to be conditional on fulfilment of certain conditions precedent. A guarantee is a collateral engagement to answer for the debt, default or miscarriage of another person. The liability of the guarantor is conditional upon the default committed by the principal debtor. The conditional liability does not come under the expression promise to pay.

A guarantee in its technical and legal sense, has relation to some other contract or obligation with reference to which it is a collateral undertaking. It is a secondary and not a primary obligation. If there is no debt etc. present or future, there is nothing to guarantee and, therefore, there can be no contract at all. In a guarantee, the obligation of the guarantor, is, that the principal debtor is able and will perform his undertaking, and if he fails, the guarantor will pay the resulting damages. Where, however, the person sought to be held primarily liable prior to the breach of contract or duty of some one else, the contract in question is an original promise and is not a contract of guarantee.

It is the nature of the obligation and not its designation as guarantee, which determines whether or not the contract is one of guarantee or a contract of some other nature, is to be determined from the language used, in the light of the subject matter and the circumstances involved. A careful reading of section 126 would clearly indicate that the primary idea of suretyship is an undertaking to indemnify the debtor in case he does not fulfil his promise, the contract of guarantee being thus a contract to indemnify. The central point in such a case is to determine what was the contingency which the parties had in their mind when contract of guarantee was entered into. In order to decide that question it must be remembered that the law does not require a contract of guarantee to be necessarily in writing. It may be express or it may even be implied. It might even be inferred from the course of conduct of the parties concerned.[29]

Sometimes the problem may arise that the transaction between the parties is in more than one document. The question is whether the transaction amounts to a guarantee or not has been decided by the Supreme Court,[30] saying that it is well established that if the transaction is contained in more thanone document between the same parties they must be read and interpreted together and they have the same legal effect for all purposes as if they are one document. To the same effect is the observation of Moultan, L.J.:[31]

> "Where several deeds form part of one transaction and are contemporaneously executed they have the same effect for all purposes if they were one deed. Each is executed on the faith of all the others being executed also and is intended to speak only as part of the same transaction, and if one is seeking to make equities apply to the parties they must be equities arising out of the transaction as a whole".

The Essentials of a Guarantee

Principal debt

The general rule is that a cause of action cannot exist against a surety, unless a cause of action exists against the principal debtor. This rule necessarily results from the very nature of guarantee as being an obligation accessary to that of the principal. There is one notable exception to this rule. Where the principal is excused from liability for reasons personal to himself, which do not affect the validity of the contract or debt itself, the surety is still liable.

Likewise when the primary obligation is invalid or between the parties for lack of consideration or failure of consideration or because of illegality, it will not bind the surety. This was held by the House of Lords in Lakeman v. Mount Stephen.[32] Lord Selbourne said:

> "That there can be no suretyship unless there can be a principal debtor - nor can a man guarantee anybody elses debt unless there is a debt of some other person to be guaranteed".

The other decision of the House of Lords is that in Sawan v. Bank of Scotland,[33] in which the subject of guarantee was prohibited by and clearly void under a revenue statute. It is clear that the purpose of invalidating the principal contract was to protect the revenue and it was held that any contract dependent on or collateral with a contract void for illegality was tainted with the illegality also. The quotation from Pothier[34] also buttress the same view:

> " As the obligation of sureties is according to our definition an obligation accessory to that of a principal debtor it follows that it is the essence of the obligation that there should be valid obligation of a principal debtor, consequently , if the principal is not obliged, neither is the surety,as there can be no accessory without a principal obligation. However, where directors guarantee the performance of a contract by their company which does not bind the latter, or being ultra vires, the directors suretyship liability is enforceable".

It is also no defence to the surety that the principal debtor was an infant, with the right of disaffirmance or who has exercised that right.[35] This likewise is a personal defence for the benefit of the infant himself. Indeed, one of the purposes the creditor has in seeking a surety for performance of the minors obligation is to prevent loss for minors disaffirmance. Also it is no defence to the surety that the principal debtor, a corporation had no legal capacity under its charter to enter into the primary debt so that its doing so was an ultra vires act. The incapacity of the principal is one of the contingencies against which the surety assures the creditor. When the principal is discharged because of incapacity, the debt itself remains, and its burden is assumed by the surety. In such a case the principal is not discharged because of any defect inherent in the contract itself, that is to say, the contract is not immoral or illegal, but at most one which the corporation was without authority to make.

In view of the fact that any overdraft or loan to a minor is irrecoverable by legal proceedings, much thought has naturally been given to the question of obtaining from the minor some kind of security which will enable the lender to recover his money by indirect means. In the present socio-economic conditions it is scarely remarkable that minor should take advantage of the hire - purchase agreement which has provided him with the means of acquiring with relative case articles which used to be regarded as luxuries, but are now regarded by many infants , though not by the law, as necessities. Venders who wish to do business with infants have, therefore, had to avoid the legal difficulties surrounding such transactions as best they can, normally by insisting that some responsible person of full age join in the transaction as the minor's guarantor or surety. Secondly it is a fact that the guarantees for the debts of minors perform a useful function. They enable minors to obtain credits which they may require and which they may not be able to obtain without such guarantees. The other area of concern is that a minor admitted to some professional institution has to provide some security that after the completion of the course he has to serve the same institution for some period.

It is needless to say that a minor's agreement in India is void, vide the ruling of their Lordships of the privy Council.[36] The Chapter on "Guarantee", however, is absolutely silent whether a guarantee as to the payment of debts incurred for necessary or non - necessary purposes by the minor is valid or not.

An important issue relates to the question whether the guarantor is precluded from pleading the incapacity of the principal debtor in those cases only which he knew of it, when contract of guarantee was entered into or whether he is precluded even though he did not know of it.

The decision of the Bombay High Court in KASHIBA v. SHRIPAT,[37] is still considered the leading and unimpeachable authority on the point. The facts of this case are:

The plaintiff sued to recover Rs. 1,194 and interest on a bond. The bond was executed on 29th, Nov. 1887 by the first defendant, who was a minor. The second and the third defendants were sureties. The

Bombay High Court observed as under:

> "Section 128 has no reference to nature of the obligation but only explains the quantum of the surety's obligation . There is nothing unlawful, immoral or even improper in lending money to a minor, and we can see no reason in the absence of enactment to the contrary why a person cannot contract to guarantee the performance by a person of a duty of imperfect obligation. The case is perhaps still more clear if the promise of the infant to repay the money is void. In that case the contract of the so called surety is not a collateral but a principal contract".38

It is submitted that this decision incorporates a sound ethical principle in that no body but the principal debtor himself can benefit by the fact that the principal debtor suffers from a personal disability. This view is also supported by E.J. Cohan .

A question is raised as to what is meant by the word 'liability'? Obviously it means the liability enforceable, at law. A void contract rather than an agreement is an agreement which the law is not going to recognise. In other words which can be safely ignored by the person making the contract, because in the eyes of law such contract has no existence. From the careful reading of section 128, it clearly follows, that the surety is not liable for it says that the liability of a surety is co-extensive with that of the principal debtor.

It is beyond doubt that the liability of a minor is Zero. The liability of the surety must be co-extensive neither more nor less. The suret's obligation must substantially depend on third party's default.[40]

The same view has been expressed by Madras High Court.[41] The question before the court was whether the obligation of a surety becomes primary one when no liability has ever been fastened on the principal debtor by reason of his minority at the time of the contract. It has been held that under the English Law the basis is that credit is given to the major guarantor and not to the infant and there is no authority for the proposition that where credit is given to the infant on the footing that he will be liable - a guarantor assumes an obligation as a principal debtor.

The English courts have, however, refused to allow the Infants Relief Act to be circums-vented and have refused to enforce security provided by a minor in support of a loan. But it was commonly held until the Coutts & Co. v. Browne Lecky case,[42] that if the security was furnished by an adult in the form of a guarantee it would be effective. In the light of the decision in the above case that opinion can no longer be held.

The facts in the case were that the second and the third defendants had guaranteed the amount of a over draft by the plaintiff Bank's to the first defendant, an infant. Obliver J. examined the judgments in <u>Wauthir</u> v. <u>Willson</u>,[43] and distinguished it from the facts before him on the grounds that Willson's liability was one of indemnity rather than of guarantee and observed:

> " As the obligation of the surety is an obligation necessary to that of a principal debtor, it follows that it is of essence of the obligation that there should be a valid obligation of a principal debtor, consequently, if principal is not obliged neither is the surety as there can be no accessory without a principal obligation".

The other side of the same coin is where the surety is not knowing the infancy of a principal debtor. In other words surety believes himself to be guaranteeing a perfectly valid obligation can the surety plead the infancy of a principal debtor. Thereis no case directly on the point. But in Newzealand[44] this new principle, that the guarantee is ineffective, has been extended to the lack of knowledge by the parties of the infancy of the principal debtor. So even if the parties are not knowing the infancy of the principal debtor the surety continues to be liable. This view is supported by E.J.

Chon:

> " On principle it appears strange that a guarantor should be liable although he believed himself to be guaranteeing a non-existence debt, while another who believed that he guaranteed a perfectly valid obligation should be free from all liability, merely on the ground that the principal debtor was under some personal disability".[45]

It is submitted that the above view is inconfirmity with the spirit of law and takes into account the practical problems which a minor has to face if the surety is allowed to plead the infancy of a principal debtor.

The best course open to the Courts is that whether all concerned parties know or not that the first promisor is an infant, so that, as against him, the promise can not be enforced, the Courts should incline to construe the document signed by the adult (the second promiser/surety) as an independent contract.

It is submitted that the Indian Contract Act is amended and expressly it is laid down, as has been done by the American Restatement, that the incapacity defence is personal to the principal debtor and should not be pleaded by the surety. If the surety did not know of the incapacity and the creditor knew of the fact and did not disclose it to the surety this may well be a defence based on the non-disclosure of a material fact.

Another valid defence available to the surety is that the statute of limitation has run in favour of the principal against the creditor, on the ground that it would be in-equitable to require the surety to pay because the surety's right of reimbursement against the principal debtor has likewise been barred. Another reason sometimes advanced for discharging the surety when the Statute of limitation has run on the principal debt is that there has been an extinguishment of the debt by the bar of limitation and therefore the surety is released.

The above view is not a very persuasive argument, since before the claim was barred, the surety could have paid the debt and sued for reimbursement, or it could have required the creditor to sue by giving it a notice to do so. Hence the surety is liable in the absence of a principal debt.

Consideration

Every contract not under seal must have a consideration to support it. This consideration is either expressed in words or implied from the very nature of the contract. It is implied in the case of bills or

Notes. It being a presumption of law that every bill or Note, whether expressed or not to be for a value received, was given for adequate consideration. The holder suing on the instrument has not to prove or allege the consideration. Contracts under seal are not only valid without any expressed consideration but are valid without any consideration.[46] The reason why a contract under seal is valid without consideration is because an engagement of this description is of so solemn a character that persons entering into it must be presumed to have previously determined upon what they are about to do.[47]

Like any contract, a contract of guarantee must be supported by consideration.[48] No court of law has ever decided that there must be a consideration moving directly between the person giving and the person receiving the guarantee, it is enough if the person for whom the guarantee is given thereby receives a benefit or advantage, or if the party to whom it is given suffer a detriment or inconvenience to form an inducement to the surety to render himself liable for the debt of the principal. Under section 127 of the Indian Contract Act, anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee. It is not necessary that the consideration should flow from the creditor andbe received by the surety.[49] Consideration between the principal debtor and the creditor is good consideration for the guarantee given by the surety.[50] In Ghulam Husain v. Faiyaz Ali,[51] it was argued on the basis of the definition of consideration in section 2(d) of the Indian Contract Act,[52] that in order to show that the bond in question was for consideration it must be proved that the lease was given to the principal debtor at the 'desire of the surety'. The court held, however, that under section 127 of the Act it is not necessary that the thing done or the promise made for the benefit of the principal debtor should be at the desire of the surety and that section has implied in it some such expression as notwithstanding anything contained in section 2(d) of the Act", for, otherwise, there was no need to enact section 127 in as much as anything done or any promise made for the benefit of principal debtor, if done or made at the desire of the surety would clearly come under section 2(d). This interpretation is correct keeping in view the object of the contract of guarantee.

Also it is not necessary that surety should receive any advantage himself. The very nature of contract of guarantee does not stipulate for the surety, to receive or, for that matter, retain the money or advantage himself or the actual beneficiary is the principal debtor.[53]

The consideration for guaranteeing an existing debt is commonly either a forbearance on the part of the creditor to press for the debt, or the allowance of a future credit or advance. Though credit has already been given to the principal debtor without any promise of surety, an agreement by the creditor definitely extending the time of payment or performance or otherwise definitely to forbear to exercise legal rights against the principal debtor, is a sufficient consideration for the undertaking of surety.[54] The reason being that the creditor has suffered a detriment at the request of the surety in relinguishing his legal right to proceed against the principal. An agreement to forbear for a reasonable time, and though there be no promise for a definite extension of time, to the principal, the creditor's actual forbearance for a reasonable time, at the express or implied request of the surety, to pursue his remedies against the principal debtor is a sufficient consideration for the surety's undertaking.[55] But mere voluntary forbearance by the creditor without request on the part of one who subsequently signs as a surety is no consideration for the undertaking of the latter. It is no more than a voluntary courtesy to the principal debtor.

A mere recommendation must be distinguished from a contract of guarantee. So a recommendation by one party to another to do something, e.g. to lend money to a third party liable as a guarantor for the loan, if given.[56] So also, a mere recommendation by C, that A should buy goods of B, will not entail on C the consequences that might flow from his guaranteeing that A will not suffer any loss, if he takes up B's offer of sale.[57] The mere fact that a person tells that the creditor might safely do business with the principal debtor falls for short of a guarantee.[58]

There is considerable conflict of opinion as to whether the past benefit to principal debtor amounts to a good consideration. In other words whether past consideration can be a good consideration for a contract of guarantee. One view is that the past consideration or the past benefit to the principal debtor could be a valid consideration for a bond of guarantee.[59]

This view is based on the ground that the word 'done' in Section 127 shows that the past benefit to the principal debtor can be a good consideration for a bond of guarantee.

On the other hand some other High Courts take the view that the past consideration or past benefit to the principal debtor cannot be a good consideration for a contract of surety. This view is buttressed by a reference to illustration (C) of section 127 of the Indian Contract Act, made it clear. From this it is clear that anything done or any promise made for the benefit of the principal debtor must be contemporaneous to the surety's contract of guarantee in order to constitute consideration therefore A contract of guarantee executed afterwards without any consideration is void.[60]

Though this conflict has not been finally resolved yet the view that past consideration or past benefit to the principal debtor cannot be a good consideration for a contract of guarantee appears to be more in consonance with the letter and spirit of the law.

Misrepresentation

Mutual assent of the parties is an essential element of a contract of guarantee. It means that the minds of parties must meet in the same sense on the same matter. A mistake may render an apparent contract of guarantee null and void, though there may have been no fraud or misrepresentation. A guarantee is apparently invalidated only where there has been a fraudulent concealment of material facts which should have been disclosed, though it is not necessary that such concealment should in order to have that effect, have been intended to benefit the person guilty of it.

Where a surety is induced to enter into a contract of guarantee by fraud or misrepresentation on the part of the person to whom the guarantee is given, or to some fact or circumstances affecting the liability of the guaranter, such fraud or misrepresentation operates to discharge the guarantor from liability. The Indian Contract Act, provides for cases of mistake, coercion, undue influence, fraud and misrepresentation in sections 13 to 22. The Chapter on guarantees, however, embodies only two specific sections, namely section 142 and 143.[61] These sections cover the same ground as section 19 of the Act with the exception that the requirement of this section is that the misrepresentation made by the creditor must concern a material part of the transaction does not expressly appear in section 19. This section only applies in case of a misrepresentation concerning a material part of the transaction made by the creditor, or by some one else with his knowledge or assent. It can have no application to a misrepresentation made by the debtor without the knowledge and assent of the creditor.[62]

Fraud vitiates all contracts, including of course the contract of guarantee. Fraud cuts down everything and the law sets itself against it to the extent of breaking through almost every rule, sacrificing every maxim ,getting rid of every ground of opposition, technical or otherwise, so that justice and truth may prevail.[63]

Fraudulent concealment may consist not merely of the omission to disclose such facts as need be mentioned only in answer to the surety's questions, but also the non-disclosure of facts which the creditor must spontaneously disclose to him, and the critérian whether such disclosure should be made is whether there is anything which might not naturally be expected to take place between the parties who are concerned in the transaction, that is, whether there is a contract between the debtor and the creditor to the effect that his position shall be different from that which the surety might naturally expect. It depends on the nature of transactions in each case whether the fact not disclosed is such that is impliedly represented not to exist.

Where the surety is induced to sign by fraud of the creditor, or by fraud to which the creditor is party, or of which he has knowledge, when he remains the surety, the surety is not bound. If there is a wilful false representation or the active concealment of a material fact, there is little or nothing that is special to the subject in hand. The principal, question is as to the creditors duty to make disclosure. The general rule on this subject where inquiry is made by the surety have been well stated as follows:

> " The law is that if a person who contemplates becoming surety to another for the payment of money or the performance of any act by a third person applies to the creditor or to person to whom the security is to be given for information as to the nature, extent and risk of the obligation, or the circumstances, condition or character of such third person, the creditor, if he undertakes to give information, is bound to disclose every material fact within his knowledge affecting the proposed

> liability. This especially is so where the obligation of suretyship is entered into at the request of the person to whom the security is given. In such a case perfect good-faith is required on the part of the creditor. The contract of guarantee, however, like the contracts of insurance, is not in strictness uberrimae fidei, as one in which there is an obligation, irrespective of some fiduciary relation between the parties, to make full and voluntary disclosure of all matters known to the creditor that would or might be material to the surety's risk, in the absence of inquiry by the surety." 64

There is, however, no universal obligation on the part of the creditor to make disclosure of facts to the surety, and the duty to make disclosure, or any implied representation, depends on the particular circumstances of the transaction, which may show that the creditor has guarded himself against liability for non-disclosure or implied representation. If the intending surety is unacquainted with the risk he is undertaking, he should make inquiry on the subject, the creditor being under no obligation to inform him of matters affecting the debtor's credit, or if any circumstances unconnected with the transaction in which he is about to engage, rendering his position more hazardous. If the creditor has made a statement which he believes to be true, but which in the course of the negotiations, he discovers to be false, he should correct it.

Although a contract of guarantee is not of utmost good-faith. Nevertheless, it may be so depending on the circumstances, for guarantees are closely construed in favour of the surety. For example, in a guarantee for the fidelity of a servant an innocent omission by the employer to inform the surety of the servants previous dishonesty whilst in his employment was held to bar the employer from enforcing any claim in respect of the servant's subsequent dishonesty.[65]

In the case of a guarantee for a customer requiring and applying to his bankers for cash credit, the omission to disclose spontaneously to the intending sureties the actual state of the customer's account or suspicious as to his honesty will not necessarily vitiate the guarantee. It has been held in Hamiltan v. Walson,[66] that the bank, if not asked for the information as to how the debtor's account has been conducted, whether the debtor is already overdrawn or whether he has been punctual and honorable in his dealings. Although the bank is entitled to assume that the guarantor has made himself acquainted with the debtors reputation and financial position, the bank must exercise care to avoid any possible charge of misrepresentation. If any information is given it must be full and fair, and if the guarantor asks question, the bank must make unequivocal replies. So far as disclosure is concerned, the bank may feel constrained by its duty of secrecy owned to its customer, and so it is probably better to arrange for a tripartite meeting of bank, customer and the proposed guarantor to discuss the matter, or else to get the customer's authority for disclosure of the information sought by the guarantor.

A bank should not suggest the name of a possible guarantor to a customer, lest the guarantor should subsequently argue that the bank had made the customer as its agent, so that any misrepresentation by him might enable the guarantor to avoid liability. There is a duty not to mislead a prospective guarantor and "very little said which ought not to have been said, or very little omitted which ought to have been said", will avoid the contract.[67]

Misrepresentation, as distinguished from concealment, may be either written or oral and may consist if such a suppression of the truth by the partial, inaccurate and decitful setting forth by the creditor of facts within his knowledge material for the proposed surety to be informed of as, along with the non-communication of the facts material for the latter to know, amounts to misrepresentation. Misrepresentation usually consists of direct assertion of a fact which is not a fact and which is calculated to influence a person becoming a surety. If a contract of guarantee is induced by a material misrepresentation by the creditor, it may be set, aside, even if the misrepresentation was made innocently. It is misrepresentation to frame a guarantee so as to mislead a surety as to its real effect and meaning. But if he could have procured information on the subject, but did not ask for it the surety remains liable.

Keeping silence, or concealment, which is not fraudulent in fact or in law, will not avoid a guarantee, and the creditor is not required to make any disclosure or explanation, the withholding of which would not amount to a fraud.

Though the law requires the creditor to act in good faith, unless he has knowledge of or participates in the concealment, he is not responsible for any misrepresentation or concealment practised by the principal debtor, on the surety, in order to induce him to enter into the contract of guarantee. Yet, if the creditor participates in a false representation or frudulent concealment of facts which operate to induce the making of the contract of guarantee, the surety may set up such misrepresentation or concealment as a defence in an action on the guarantee. So also, if the creditor knows that the surety is entering into the contract, because induced to do so by misrepresentation or concealment of facts by some third person, the contract of guarantee is not binding.

The expression keeping silence implies intentional concealment as distinguished from mere non-disclosure, which no doubt is of itself a fatal objection in insurance contracts and virtually expresses what is laid down in North British Insurance Co. v. Lloyd[68], that the withholding must be fraudulent, which necessarily must be the case when a material circumstances is intentionally concealed.[69] In order to avoid the guarantee it must not only be proved that there was a silence as to a material circumstance but also that the guarantee was obtained by means of such silence.[70]

Where the relationship between the bank and the customer is such that there is an element of trust and confidence between the two and the customer of the bank is either old and ignorant, or weak, in such a case, the bank must exercise due diligence and allow the customer to get independent advice and not obtain documents from the customer without his full knowledge and understanding the significance of his act. More often it happens in practice that printed form with the banks are filled in by the officers of the bank and the same are signed on the spot by guarantors who barely read through the forms and sign the same forthwith. The party may do so for the purpose of obtaining immediate advance from the bank. However, subsequently, the person signing the forms at the request of the borrower may contend that he had either not completely read through the form, nor understood the significance of what he was doing and had no opportunity to obtain independent advice. The bankers should act more carefully and deligently whilst getting mortgages, guarantees and other similar forms signed by the guarantors at the request of the borrowers.

The banker is not bound to volunteer to a proposing guarantor information as to customer's financial position or business habits, however, material such information might be but if the banker is questioned by the intending surety on a point which might have a material bearing on the surety entering or not entering into the guarantee, in such a case the banker must give the requisite information, honesty and the best of his ability, the occasion justifying the disclosure being implied in the introduction of the surety. Any misrepresentation on the part of the bank as to the nature, contents or effect of the guarantee would entitle the surety to rescind or treat the instrument as rescinded. The custom of entrusting the guarantee to the principal debtor to get it executed by the surety should be avoided.

The safest course, and the one normally adopted would seem to be to have the guarantee signed and witnessed by the surety bankers, so as to avoid any question of this sort.

Fidelity Guarantee

Since much of the business today is conducted by agents, it becomes necessary for the principal to exact the utmost honesty and goodfaith of his agent in the performance of his duties. Whenever the principal is unwilling to repose such confidence in the agent alone, he usually obtains what is known as a bond or faithful performance that is signed by the agent and some third party. A contract of suretyship, therefore, appears to have for its objectives, security either for the payment of the money or the faithful performance of some other duty, in the latter case often being known as fidelity insurance.

Before the writing of surety bonds became an established business, persons acting in a fiduciary capacity or occupying positions of trust, if sureties were required, were obliged to appeal to relatives or friends. While it was not unusual for the personal surety to require compensation for participating in the agreement, more often than not the surety signed his name to a bond without remuneration and purely as a favour. Corporate surety bonds were offered first in England during the early part of the Eighteenth century. In the period around 1720, when mony strange insurance proposals made their appearance in England, a company offered to insure masters against loss through the dishonesty of their servants.[71]

It was not until 1840 that the corporate fidelity business became established with the organization of an English Company to write the business. The first American Company was organized in New York in 1853, following enactment by the Newyork Legislature of a law authorising the formation of corporations to insure the honesty of employees.

Corporate suretyship was slow in developing. There was considerable resistance to the substitute of the impersonal corporation for the locally known personal surety. However, there was the growing reluctance on the part of the individuals to assume gratuitously obligations in which they had no immediate interest. Corporate sureties were more and more accepted, and as the idea become increasingly reluctant to assume obligations without remuneration that corporations were ready and willing to assume for a consideration.[72]

A second factors that tended to stimulate the development of corporate suretyship was the performance and stability of the corporations in the business. They are subject to the regulations provided by the Statutes, they have a lasting and permanent organization . It is their chief function to meet losses when they come, consequently, when losses develop, they are ready and willing to pay.

The rule is generally well settled, that where the surety is liable upon the continuing undertaking for the honesty of a servant, ifthe servant has been guklty of acts of dishonesty in the course of the service to which the suretyship relates, it is the duty of the employer, upon discovering the fact, to discharge him or to disclose such dishonesty to the surety and secure his consent to the continuance of the services and if he fails to do this he cannot after-wards have recourse to the surety for any loss that may arise for the dishonesty of the employee during the remaining period of the service.[73]

This rule is founded not only upon obvious considerations of justice and fairness to the surety but also the implied intention and expectations of the parties. The guarantor in such a case guarantees the fidelity of the servant. He guarantees the fidelity and ensures the loss against the risk of infidelity and not the fact of infidelity if the rule would have been otherwise it would be to permit the employer to encourage dishonesty at the cost of the surety which will not only be against all known notions of fairness but also be most repugnant to the elemantary considerations of public policy.

The continued employment of a servant without notice to the surety, in order to discharge the surety must be after the creditors or employer has proof of the servant's acts of dishonesty and not merely suspicious or reports about it. The theory is a theory not of suspicious but of satisfaction.[74]

It is submitted that the employer starts immediate investigation to find out what the actual fact is. Although a contract of insurance is not one of uberrimae fidei, but a contract strictissina Juris.[75] But at the sametime a surety is considered as a favoured debtor.[76]

The suretyship contract, however, may impose special terms upon the employee regarding notice of irregularities or default of the principal, and the conditions imposing special duties upon the obligee so long as the employer observes goodfaith, the obligee is not bound to exercise supervision of his employee or to adopt any particular means to prevent or ascertain his default. Most bonds of this kind, however, contain special provisions in this behalf. A common one being that the bond is made and accepted by the obligee upon the condition or upon the basis that there shall be a careful periodic examination of the accounts of the risk.

such provisions are in the nature of promissory warranties or conditions subsequent, and non-compliance, there-with avoids the bond.[77] In the case of individual surety, when he affixes his name to the bond, his financial strength may be beyond question. If the bond runs for any considerable period of time, the financial status may change entirely, even to the extent that the surety may be without capacity to meet this obligations. It is easy to investigate the standing of a corporate surety. It is not so easy to know the status of an individual or to be assured that financial reverses may not have the effect of changing that status without the knowledge of other parties in whose interest a bond is written can exercise no supervisory control over individual sometimes and have no way of assuring themselves of continuing solvency. Individual sureties are unable to supply a bond with the same safety and stability as can a surety company.

Difference between guarantee and insurance

A contract under which an insurer undertakes to make good loss caused by the default of a debtor bears close resemblance to a contract of guarantee. There is, however, a broad distinction between an insurance and a guarantee. This distinction depends upon the intention of the parties. In a contract of insurance pure and simple, insurer is not a surety. Insurer does not undertake to pay the original debt, but undertakes to pay new debt, which arises out of the contract of indemnity. This debt may differ from the original debt both in the amount and as regards other incidents.

The subject-matter of a guarantee is always a debt either always incurred or intended to be incurred by the principal to the person taking the guarantee, or which though not already incurred or intended to be incurred, may result in the future from some default or miscarriage of the principal in a relation already existing or intended to be entered into between himself and that person. The province of the guarantee is, therefore, narrower than that of the insurance. By insurance indemnity may be secured against loss by the acts or omissions of strangers. A surety becomes bound, it may be unconditionally and without previous notice or demand, to pay the debt or make good the default which the principal is or shall be liable to pay or make good. A surety must see he does it. An insurer only engages to pay the loss, measured in a certain way, upon the happening of a defined contingency against the happening of which he is not considered as capable of exercising any influence.

An insurer is entitled to a disclosure of all facts material to the risk within the knowledge of the assured. But a surety can only complain of positive deception by representations express or implied.[79]

It is common knowledge that the contract of insurance is uberrima fide or in the utmost good-faith. Not only is such a contract liable to be set aside under the normal common law rules of mistake and misrepresentation, but also as a special advantage of necessary disclosure. Uberrima fides is normally implied where one party has a considerable advantage over the other in terms of knowledge.

If the principle contended for, that every thing should be disclosed by the creditor, that is material for the surety to know, is allowed, it would knock up transactions in giving security on a cash account because no banker would rest satisfied that they had a security for the advance. If such is the rule, it will be necessary for the banker to whom the security is given to state how the account has been kept of over drawing, whether he was punctual in his dealings, whether he performed his promise honourably, for all these things are extremely material for a surety to know. Secondly, requirements of disclosure are not required because the guarantor is usually acquainted with the debtor anyway, and thus creditor cannot be called on to disclose to him facts of which through other sources he will probably have noticed.

In Steatan v. Heath,[80] Romer L.J. held:

> "The person desiring to be insured has means of knowledge as to the risk, and insurer has not the means or not the same means. The insured generakly puts the risk before the insurer as a business transaction and the insurer on the risk stated fixes a proper price to remunerate him for the risk to be undertaken. On the other hand - thecreditor does not himself go to the surety, or represent or explain to the surety the risk to be run. The surety often take the position from motives of friendship and generally not as the result of any direct bargaining between him and the creditor, or in consideration of any remuneration passing to him from the creditor".

There are, however, situations where a person is persuaded to go to surety for another by payment of a money premium. This is a prima facie a case when the contract should be one of insurance. Secondly where an employer in taking a bond from a surety for the fidelity of a servant, did not disclose the fact, known to him but not to the surety, that the servant had previously been guilty of misappropriating money while in his service. In this situation the rule of uberrima fidee applies even in case of guarantee.[81]

The difference between the two classes of contracts does not depend upon any difference between the word 'insurance' and the word guarantee'. The distinction is based more upon the intention of the parties than upon the mere form of the contracts.[82] There are four points upon which the relations arising between the two forms of contract can be distinguished:

(i) Insurance is purely a business contract having for its consideration the payment of premium on the one hand and acceptance of the risk on the other. In the case of a guarantee liability is generally accepted on personal grounds and without payment.[83]

(ii) Insurers do not usually have any personal knowledge of tne risk, and rely entirely upon what they are told. Thus they require the full disclosure of facts. In the case of guarantee the duty is less extensive and nothing short of actual misrepresentation can avoid the contract.

(iii) Insurers are not sureties. They do not undertake to pay the original debt, but merely agree to indemnify the creditor to the extent of loss arising from non-payment of the debt.

(iv) Insurers have no independent rights against the debtor, but are merely subrogated to the rights of the assured. A surety on the other hand, has a direct claim against the debtor.

Difference between Guarantee and Indemnity

It is generally, recognized, however, that guarantee is a contract secondary and collateral to the other promise, whereas the indemnity is an original obligation independent of any other contract. In the former three party legal relationship is contemplated, that is, three sets of contractual relationship between the creditor and the principal debtor, the second between the creditor and the surety and the third, between the principal debtor and the surety. If the first two are the only contracts, the case is clearly one of 'indemnity'. It is the third contract - the one where the principal debtor requests a third person expressly or by necessary implication to act as a surety - that constitutes a contract of guarantee.

It is often said that a contract of guarantee is one to the another for the debt, default or miscarriage of another, whereas a contract of indemnity is one wherein the promisor agrees to save the promisee harmless from a loss, or it may be said that the surety's promise is secondary and collateral to the other promise while the indemnity is original and independent of any other contract. A guarantee is sometimes said to be a promise to do an affirmative act, while the promise of indemnity is merely to repair a loss, the liability of the indemnitor occuring only after the promisee has sustained actual loss. Still another definition says that a promise of guarantee is one to protect the promisee against loss from the default of a third person, while a promise of indemnity is one to protect the promisee from liability to a third person.[84]

A guarantee runs to the benefit of the creditor while an indemnity runs to the benefit of the debtor, gives a workable basis for distinguishing the two. The distinction is necessary when dealing with an absolute guarantee in order to determine whether the person secured must suffer loss to acquire a right of action or whether the debtor's mere fault is sufficient.

That is, typically, guarantee is said to exist when the two persons are liable on the same debt, one as Principal, one contingently liable if the principal defaults and the normal expectation is that the debt will be paid by the principal, or that he will reimburse the surety in the event of payment by the surety. On the other hand, a contract of indemnity is said to exist when, upon, the occurance of an agreed contingency, one person alone becomes liable to the obligee.

The most important practical effect of the distinction, as is well known is that guarantee contracts fall under the statute of Frauds 1677. Section 4 requires evidence in writing and signed by the other party before they can be enforced in the courts. Indemnities on the other hand require no such evidence and can be enforced even when orally made. Although a contract of guarantee may be described as a contract of indemnity, points out Halsbury, yet contracts of guarantee are distinguished from contracts of indemnity ordinarily so called by the fact that a guarantee is a collateral, that is, ancillary or subsidiary to another contract, where as an indemnity is a contract which is original and independent obligation. In certain cases, where there is a primary and secondary liability of the two persons for one and the same debt, they may stand in relationship to one another of principal debtor and surety, even though no express contract of suretyship exists. The existence of such a primary and secondary liability does not, however, in every case necessarily create the relation of principal debtor and surety. Thus despite the fact that there is primary and secondary lkability, for instance between the transferee and the transfer of shares, the relation between them is not that of principal debtor and surety.[85]

The guarantee cannot, however, be collateral unless another is, or is to be also liable. If two come to a shop and one buys, and the other says to the seller:

> "Let him have the goods, I will be your pay-master, or I will see you paid'. This is an undertaking as far himself, and he shall be intended to be the very buyer and other to act but as his servant. 86

Whatever the language used, the question must be whether they intended that the promisor should assume sole or subsidiary liability. Even the stark phrase, let him have the goods, I will see you paid, when thus read in the light of the contract, may mean not more than that of he does not pay, I will[87].

The English Law applies various kinds of tests to distinguish between a contract of guarantee and a contract of indemnity. The first test relates to the shape[88] of the contract and the second test relating to the substantial nature[89] of the contract. The tests are both objective and no weight is to be given to the intention of the parties.[90]

Whether a contract is one of guarantee or indemnity can thus be answered, sometimes, only by referring to the circumstances which gave rise to the need for the use of that distinction and there certainly cannot be any basis for predicting, at the time a contract is made, into which category it may fall.

The question whether the agreement amounts to a contract of guarantee or indemnity is of an academic nature involving technical hair-spletting and is not much productive. The remedy, if any, would seem to lie in ignoring entirely the supposed categories and actually deciding cases on the particular factual issues presented. But in the absence of such a remedy, it must be recognised that definitions of the guarantee or indemnity are cost in terms of the result rather than in terms that will lead to results.

impossible to work out the rights and liabilities of the surety under the Contract Act. However, the same High Court.[92] Has held that after it is possible that the relationship of creditor and the surety be created without the principal debtor being a party to it. But in such a case. the rights of the surety will be limited to those mentioned in sections 140 and 141 of the Act and does not extend to those mentioned in Section 145.

In a contract of indemnity the indemnifer on paying off the claim can sue the third party, but the suit in the absence of any assignment can only be in the names of the promisee, i.e. indemnifier. There is no subrogation in the law in case of contract of indemnity, unlike that of a surety who undertakes the obligation at the request, express or implied of the principal debtor. In a contract of guarantee it is provided by section 140 of the Act that after payment or performance of the duty the surety is invested with all the rights which the creditor had against the principal debtor. In other-words, the surety steps into the shoes of the creditor to enforce any remedy against the principal debtor, and he can maintain an action against the principal debtor in his own name. To appreciate the distinction between a contract of

The distinction between the two types of contracts is that in a contract of guarantee, the surety assumes a secondary liability to answer for the debtor who remains primarily liable. Secondly a contract of guarantee is a tripartite agreement, which contemplates the principal debtor, the creditor and the surety, but on the other hand, in a contract of indemnity there are only two parties. In Periyanianna Masakayor v. Baniars & Co., Kumara Shastri, J. of Madras High Court observed:[91]

> " That the Contract Act, draws a distinction between a contract of indemnity and guarantee, and that contracts of suretyship, unlike contracts of indemnity, require the concurrance of three parties, namely, the principal debtor, the creditor and the surety. The surety undertakes his obligation at the request express or implied of the principal debtor. Reading section 126 and 145 , it seems that there can be no contract of guarantee as distinguished from a contract of indemnity unless there is privity between principal debtor and the surety,as it is difficult to speak of an implied promise between persons whom there is no privity of contract. Section 126 refers to contract of guarantee and speaks of three persons with reference to that contract".

In strict sense all contracts of guarantee are contracts of indemnity, and unless there is privity among the principal debtor, the creditor and the surety, it is indemnity and guarantee, the case of Bank of India Ltd. v. G. Govinda Prabha,[93] is important. The facts were that A and B, agent and clerk of a bank, when called upon to explain an irregularity in granting two loans to different persons, executed an agreement to see the repayment of the loan within a month, and also binding themselves personally to pay the amount if the debts were not discharged within the agreed time. After the expiry of one month, the bank filed a suit against the principal debtor and also against A and B. 'B' contended that the agreement in question was without consideration, and, therefore, void. The court rejected the plea and distinguished between contract of guarantee and a contract of indemnity as :

> " A contract of guarantee involves three parties the creditor, the surety and the principal debtor. There may be a contract, first of all between the principal and the creditor. That lays the foundation of the whole transaction. Then there may be a contract between the surety, and the creditor by which the surety guarantees the debt and the consideration for the same may move either from the creditor or from the principal debtor, or both. But if these are the only contracts, the case is one of indemnity.

In order to constitute a contract of guarantee, there must be a third contract, by which the principal debtor expressly or impliedly requests the surety, to act as surety, unless that element is present, it is impossible to work-out the rights and liabilities of the surety under the Contract Act".

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73. Phillips v. Foxall, L.R.Q. 666; Radha Kanta v. United Bank of India,A.I.R. 1955 Cal. 217; Co-operative Commission Shop Ltd. Chakghunsa v. Udhan Singh, A.I.R. 1944 Lah. 424; The decision of Harries C.J. and Mahajan ~~th~~ J. laid down the well known principle that continued employment of a dishonest servant whose dishonesty has been proved or is clear, without notice to the guarantor will discharge the guarantor.

74. Ibid.

75. Ibid.

76. Chittaranjan Banerjee v. Commissioner of Lakhimpur, A.I.R. 1980 Gau. 62

77. Hent v. Fidelity and casuality Co. 99 Fed. 242

78. Hukum Chand Insurance Co. v. Bank of Baroda, A.I.R. 1977 Kant. 204

79. Rowlatt, Principal ans surety 2nd Ed. ,p.10

It seems equally settled that this rule uberrima fidi does not extend to contract of guarantee. It is clear, said, Sheuj in Lee v. Jones, (1864) 17 C B.N.S. 482, that the rule which prevails in assurance and life risks that all material circumstances known to the assured must be disclosed by him and that the non-disclosure of them, though innocent and not fraudulent, vitiates the contract does not apply to the contract of guarantee".

80. (1899) 1 Q.B. 782

81. Supra note 72; supra note 65

82. C. KAMLSHWARA RAO, Treatise on the law of insurance, 1957.

83. Lee v. Jones, supra note 79

84. Somers v. U.S. Fidelity and Guaranty Co.,191 Cal. 542 (*cited in Yale Law J. Vol. 44 P.1054*)

85. 18 Halsbury's Laws of England, Supra note 12 at ~~xxx~~ 416

86. Birknyar v. Darmel, (1704) 1 Salke 27

87. Supra note 19 P. 180

88. The case of East wood v. Kenyar, (1840) 11 Ad. and El. 438, is a good example of this comparatively simple test. In the words of Lord Dennar :

" The plaintiff was liable to Mr. Blackburn on a promissory note, and the defendant, for consideration promised the plaintiff to pay and discharge the note to Blackburn . Doubtless the Statute would have applied, it would then have been strictly a promise to answer for the debt of another, we are of the opinion that the Statute applies to promise made to the person to whom another is answerable"

89. Mount Stephen v. Lakeman, (1874) Q.B. 196; Yeoman credit v. Latter, (1916) 2 All. E.R. 294. Thus if the purpose of the transaction is to replace the debtor entirely by placing the debt on anothers shoulders, the Statute will not apply.

90. Michael C. Bahair, The Conversion of guarantee Contract, Mod. L.Review Vol. 29 P. 522

91. A.I.R. 1926 Mad. 544; Punjab National Bank v. D.C. Mills, A.I.R. 1970 S.C. 1973; [illegible] Ram Chandra v. Shapurji, A.I.R. 1940 Bom.315; Janwatraj v. Jethmal, A.I.R. 1958 Raj. 343; Municipal Committee Baldana v. Vishnu Damodar Bhalrag, A.I.R. 1949 Nag. 48

92. Muthuraman China v. Vellyan, I.L.R. 39 Mad.115

93. A.I.R. 1964 Ker. 217; Radha Kumar v. Ram Narain, A.I.R. 1952 All. 587.

CHAPTER - III

CONTINUING GUARANTEE — ITS NATURE ,REVOCATION ETC.

The question whether a guarantee is a continuing guarantee or not may be considered under two heads. The first class of cases consists of ordinary mercantile guarantees for a current accounts either for goods sold, or for money advanced or some consideration of the like nature. The second class of cases arises where guarantees have been given for the good behaviour of a person in some office or employment. Sections 129 to 131,[1] of the Indian Contract Act, deal with the nature and revocation of a continuing guarantee.

All guarantees must be either specific or continuing. If restricted by their terms to a single transaction or within a fixed limit of time they are temporary. If not so restricted they continue in force until revoked. The latter class are called continuing guarantees. A continuing guarantee must refer to a series of transactions of which, when the guarantee is given, some are unknown, indefinite or uncertain. Where the guarantee is given in respect of a single existing transaction, namely the payment of a specific sum, the guarantee is a simple guarantee.[2] To determine the difference between a simple guarantee and a continuing guarantee one has to examine the nature of the consideration. If it is fragmentary and divisible, supporting for example a running or floating balance, the guarantee is continuing and revocable. If it is entire, supporting , say the grant of a lease or the fidility of an employee, it is non-revokable.[3]

The question often mooted is what is the effect of presence or absence of clauses expressly limiting liability on the nature of guarantee. Another moot question worth examining is whether a general authority, without any words of limitation as to time or amount, to make advances to another on the credit of the promisor, will bind the surety for any amount at any time until revoked, or whether he is bound merely for any amount the principal asks for and receives at the time he presents his letter of credit.

To restrict such obligations to a single transaction and construe it as a limited guarantee is to adopt the view that instruments of guarantee should be construed most strongly in favour of the surety, and to construe the instrument as a continuing guarantee is to adopt the other extreme view that the construction should be most strongly against the surety.[4]

Chitty while dealing with continuing guarantee expressed the opinion:[5]

> "It is often a difficult question whether a guarantee, for example, of the price of goods to be supplied, or may be lent up to a specified amount is tendered , to extent to a single or definite number of transactions, or whether it is intended to be a continuing. In the former event, payment of the principal debtor for the goods sold, or repayment of money lent, brings the surety's liability to an end, in the latter event, the surety remains liable if further goods are supplied or money lent up to the limit of the guarantee".

Whether the guarantee is continuing in any case is a question of construction, no hard and fast rule can be laid down, and the contents of one document affords little or no guidance to the constructions of an-other. Each case depends entirely on the language used and the document must be looked at with reference to the circumstances under which it was given. The expression from time to time" or until further notice will usually, if not always be conclusive of an intention to make a continuing guarantee.[6]

Continuing guarantee in accordance with section 129 of the Contract Act, would only mean a guarantee which extends to a series of transactions Therefore continuing guarantee speaks of continuing transactions, not the period of such transactions. Therefore, it is quite possible that a guarantee can be confined to a series of transactions and can be restricted or limited to one year. Hence there can be a continuing guarantee for a fixed period.[7] The illustrations appended to section 129 has created confusion among various High Courts in order to determine the nature of the guarantee. It has been pointed out by Rangoon High Court[8] that the illustrantion to the Contract Act are to be used as guides only and not as authoritative and binding declarations of the law. It is to be noted firstly that illustration (a) is apparantly not based upon any specific English case, such as the two subsequent illustrations are. Again in S.N. Sen v. The Bank of Bengal,[9] it has been observed that there is hardly any modern case in which guarantee has been held to be continuing one, which depends upon a main contract of employment between a master and a servant in the nature of a surety for the servant's fidelity.

The only surviving cases of continuing guarantee are those in which a third party stands surety for the due discharge of a mercantile account or a floating balance between businessmen. The court held that illustration - (a) of section 129 is wrong as a statement of law.

Where a guarantee is meant to cover a series of transaction or no time limit has been fixed, but containing limitation as to the amount for which the surety will be demanded, it will , in general, be construed to be a continuing guarantee. The time limit mentioned in such a guarantee ordinarily is deemed to have reference to the amount of the surety's liability, and not to the amount of dealings between the principal debtor and the creditor, and the surety will be held liable to the extend of his guarantee. The principal debtor may have during the contract contracted debts to an amount equal to or greater than that agreed to. Thus I agree to be responsible for the price of goods purchased of you either by note or account, by H, at any time hereafter, to the amount of $ 1000 , was held continuing . So that though H. bought $ 1000/- worth of goods from the creditor and paid for them and then bought other goods of him in excess of that amount, the guarantor was held liable for $ 1000 of the balance due to the creditor.[10]

Where a guarantee contains no express limitation as to either time or amount, and there is nothing in the instrument itself to give rise to the conclusion that it was the intention of the sureties to leave it open as to both, the guarantee may generally be understood as refering to a single transaction. Thus if you will let the bearer have what leather he wants and charge the same himself, I will see that you have your pay in a reasonable length of time. It was held to confine to a single transaction. The court said: "we think it is limited to a single transaction or purchase. We must hold this or that it is unlimited both as to time and amount. Every man is supposed to have some regard for his own interest and it is not reasonable to presume any man of ordinary prudence would become surety for another without limitation as to time or amount unless he has done so in express terms or by clear implication.[11]

The document should be interpreted as a whole and is not to be confined to the operative part. If there is any ambiguity or uncertainty it is permissible to press into consideration the nature and character of business, the relative position of the parties and surrounding circumstances.[12] In Sankaranaeayna v. Paramasivan,[13] it has been held that there is no analogy between a security executed by a surety under section 55(4) C.P.C. and a continuing guarantee as defined in section 129 of the Contract Act. In the former case, there is no series of transactions giving rise to a distinct liability which the guarantee is intended to cover but there is only a single transaction under which the surety takes the responsibility for certain things to be done in future though on different occasions. But where a person becomes a surety, and executes a security bond stipulating "I, the executant, agree to become a surety for the judgment-debtor and covenant that I shall produce the judgment debtor in court on each and every occasion when his attendance is called for by the order of the court", the Contract is of continuing guarantee.[14]

Where a bond or other guarantee has been given for the good behaviour (fidelity) of third persons in office or employment, very nice question often arise as to whether the liability of surety continues after some change has taken place as to the circumstances of the appointment. These situations may arise as:

(1) The liability of the surety after the third party's appointment to the same office.

(2) The surety's liability after the third party's appointment to another, though similar office or employment.

(3) The suretys liability after a change has taken place in the duties or the length of the term of the third person's office.

In the celebrated case of Lord Arlingtan v. MERRICK,[15] the guarantee was conditioned for the performance of the duties of deputy postmaster, by A.B. for and during all the time he shall continue deputy postmaster. It appeared, however, from the recital in the bond, that the plaintiff had appointed A.B. to act as Deputy Postmaster for the term of his six months. It was accordingly held, that the general words of the condition was restricted by the recital, and that the liability of the defendant under the bond or surety for A.B. ended only during the six months and did not extend to subsequent re-appointment to the same office. In Peppin v. Cooper,[16] a bond was given which after reciting the appointment of Henry Warren to be a Collector, under an Act of parliament which made the office an annual office. The due collection of rates and dues at all times hereafter" was guaranteed. Abbott, C.J. said, " I am of the opinion that the condition of the bond is satisfied by the faithful collection of rates and dues for the period of one year. It is true, that the words at all times hereafter, in the condition of the bond, would taken by themselves, extend the liability of the surety beyond that period. But these words must be construed with reference to the recital, and to the nature of the appointment there mentioned. Now the nature and duration of that office must be learnt from the Act of Parliament itself, for if the Statute make it an annual office, it is unnecessary to state that fact either in the bond or in the pleading. Of course, by the use of the proper words, a surety may provide for a continuance of his liability on subsequent re-appointment to same office, of the person, whose default or miscarriage is guaranteed against.[17]

Where a person is surety for another's good behaviour in a particular office, and subsequently such other person is appointed to a perfectly distinct office, which is incompatible and inconsistent with the first appointment the surety is discharged even though the duties under the two appointments be substantially indentical. But where a person, for whose good behaviour another is surety, is subsequently , appointed to an additional office or employment, the liability of the surety does not in consequence necessarily cease.[18] Of course, however, in such a case the liability of the surety would not extend to anything done or omitted by the plaintiff in respect of such additional office or employment.

Cases where, after the execution of the surety bond, a change has taken in the duties or length of the term of the third person's office or employment, or in the mode of remuneration of such third person for his services. It is well established that when the change made materially alters the duties of the office and this effects the peril of the sureties, they are released.

The liability of the surety may also be destroyed by an alteration in the mode of payment, as well as by an alteration in the duties of an office. For where a bond given by a person as surety for the good behaviour of a third person in an office or employment states that such third person is to be remmunerated for his services in a particular way, the surety is discharged from all liability if subsequentky to the execution of the bond any change be effected in the mede of remuneration. Thus as decided in The London and North Western <u>Railway Co.</u> v. <u>Whimsay</u>.[19] In 1851 the defendant executed a bond in favour of a railway co.The company had agreed to appoint L. as their clerk or agent for the purpose of selling coal. The salary was £100 per year. A gurantee was given for the due accounting by L. Of all moneys received by him for the use of the company. Subsequently it was agreed between L and Company to substitute for salary. It was held that the surety was liable for the faithful conduct of L. Whilst he continued clerk at such fixed salary, and consequently the defendant was not liable after the change in the mode of remuneration .

Whether a guarantee is continuing or non-continuing cannot be determined by fixed rules of construction, nor by reference to decide cases. They simply illustrate what the courts have done under the peculiar facts and circumstances of particular cases. Disputes frequently arise in England as to whether an instrument falls within the description of a continuing guarantee or not. There is considerable difficulty in reconciling all the cases on this subject, and the difficulty arises chiefly from their being not at one as to the principle of decision. Some cases lay down that the guarantee should be construed liberally; in favour of the person giving it, and the others, that it ought to be construed strictly.[20] Lord Ellenborough observed in Merle v. Well , "If a party means to confine his liability to a single dealing, he should take care to say so. Such a recital would restrain the generality of the engagement and explain whether it has reference to past or future transactions or continuing with reference to future transaction depends always on the circumstances under which it is given".

"Revocation of a continuing guarantee"

A continuing guarantee may either be revoked by notice or by death as to the future transactions under certain circumstances. If it appears that the guarantee was intended to be a continuing and the contract contains no express limitation as to the duration of the guarantor's liability, liability thereunder will be deemed to have continued, in the absence of anything to indicate a different intention, until notice of revocation of the contract was given by the guarantor. Speaking generally, a continuing guarantee may be revoked by the guarantor unless the terms of the contract preclude revocation. More precisely, an offer to guarantee an obligation which is to be incurred at a future time may be revoked by the offree, with the result that he may not be held liable by the creditor on account of the latters extension of credit to the debtor subsequent to the receipt of notice of revocation. Of course, the guarantor cannot revoke the guarantee so as to escape liability for credit already extended.

Where the guarantee can be revoked, the revocation cannot affect advances which have been made, or responsibilities which have been incurred on the strength of the guarantee before notice of the revocation is given.

A continuing guarantee for future advances as supplies, in consideration of granting of such advances or supplies does not become binding until the creditor has acted upon it. It may, therefore, be revoked[2]3, before it is acted upon, and as to future transactions, even if it has been acted upon, if there is no stipulation between the parties.[20]

The reason is that each advance or supply, or each transaction is a separate transaction, and the guarantee is divisible as to each advance or supply. It ripens into a irrevocable promise or guarantee as to each advance, supply and transaction only when the same is made.[22] If the surety finds the principal debtor untrustworthy, he is entitled, on the payment of what has been advanced to the principal debtor upto date, to get the guarantee back. In <u>Lloyd's</u> v. <u>Harper</u>,[23] James L.J. said:

> "It may be considered equitable and right that where a man is not under any obligation to mka make further advances or to sell further goods, a person who has guaranteed repayment of such advances, or payment of the price of the gȯods, may say. I do not sell any further goods or make any further advances. I give you a warning that you are not to rely on my guarantee for any further advances which he make; or any other goods you sell'. That might be in many cases an equitable view, it might perhaps be hardly equitable for a banker or merchant to go on

> making advances after receiving
> notice from the guarantor that
> he would not be further liable".

Where the guarantee is a continuing one, the surety can at any time revoke the guarantee by notice to the creditor. So where a guarantee relates to a number of payments of rent, extending to a series of transactions, it is a continuing guarantee. The surety can revoke the guarantee after a notice to the creditor. The surety is not responsible for the payment of the rent which accured after the surety has revoked the contract and guarantee by notice.[24]

A distinction is to be made between entire and individual consideration on the one hand and fragmentary and divisible consideration on the other hand. In the former case, all guarantees which relate to the conduct of a person admitted to an office of trust; or to the possession of property. In such cases, the consideration is a single act done once for all and is not divisible. In Abdul v. Belayat Ali,[25] it has been held that under section 130 a continuing guarantee may be revoked at any time as regards future transactions. It is a well known class of cases and there have been many cases in English courts in which a surity has been allowed to withdraw, where the guarantee has been found to be a continuing. But no case has ever established where a surety has given a guarantee to cover a definite case, he can simply by notice to the creditor withdraw the guarantee to nullify altogether the effect of the security. The consideration is entire, supporting, as the grant of lease or the fidelity of an employee. But there is one authority to show, however, that in the case of a fidelity guarantee once exact information has reached the surety that the principal debtor has been guilty of misconduct or the position has completely changed, the surety is entitled to recall the guarantee as against the creditor. For example in the case of <u>PHILLIPS</u> V. <u>FOXALL</u>,[26] it has been observed:

> " But if there is misconduct on the part of the person whose fidelity is guaranteed, for instance, if a man guarantees that a collecting clerk shall only account for all money received by him and that collecting clerk is found to have embezzled his employer's money, reason requires that the man who entered into the guarantee because he believes the person to be of good character, when he finds he is not so, and not to be trusted, should have the power of saying. I now withdraw the guarantee. I gave you. I give you full notice not to trust him any more. Notwithstanding all that what has been said,

> I am clearly of the opinion that a person who entered into such a guarantee and is therefore responsible for the person whose fidelity he has guaranteed has a right to withdraw that guarantee when that person has been proved guilty of dishonesty".

In the absence of agreement to the contrary, a continuing guarantee is revoked, as to future transactions, thereunder, by any change in the constitution of a firm to or for whom guarantee was given.[27]

There is, however, conflict of opinion between various High Courts regarding the revocation of bonds given in court proceedings. The Madras High Court has held in Sankaranarayan v. Paramasivan,[28] that there is no anology between a security bond executed by a surety under section 55(4) C.P.C. and a continuing guarantee as defined in section 129 of the Contract Act. A surety in the former case cannot claim to be released from the obligation at his pleasure and the principle of section 130, Contract Act, does not apply. On the other hand Allahabad High Court,[29] has held that where a person becomes a surety, and executes a surety bond stipulating, "I, the executant, agree to become a surety for the judgment debtor and covenant that I shall produce the judgment-debtor in the court on each and every occasion when his attendance is called for by the order of the Court". The contract being a continuing guarantee cannot be revoked by the guarantor as to future transactions, by the notice to the creditor.

The Lahore High Court has taken a view that a security bond furnished under section 55 of C.P.C., is in the nature of a continuing guarantee, and when the surety produces a judgmentdebtor before the court and requests to be absolved from further liability under the bond, the court should not refuse the prayer.[30] It is submitted that the view taken by Lahore High Court is reasonable that when a surety executes a security bond he cannot put an end to his guarantee at his will. But the Court has a power to exonerate such surety from all future liability, that is liability arising from future transactions or future events.

The law commission[31] | The Thirteenth Report(1958) | suggests:

"To section 130 of the principal Act, the following exception be added namely:

A continuing gurantee given to a court cannot be revoked by the surety as to future transactions without the permission of the Court".

In cases where the continuing guarantee relates, for instance, to a current account in a bank, or a current account relating to goods sold in a business, the guarantee may be withdrawn at any time , as to future transactions by notice to the creditor.

The right of revocation may be limited by express stipulation. In case, it is intended that the surety should, in default of an agreed notice, continue liable indefinetely, the intention should be clearly expressed. The law is clear that a continuing guarantee may be revoked by the surety by notice to the creditor. But to have the effect of revocation , the notice must be such as can be regarded as a notice putting an end to the contract of guarantee under this section. The mere fact, that the surety denied his liability as surety in a previous suit cannot be regarded as a notice putting an end to the contract of guarantee when the denial was made for the purpose of pleading and could not have any other effect given to it than was given in the suit itself. A mere denial of liability by a party in a previous suit cannot operate as notice, nor can the denial of existence of a legal contract have that effect. Such denial cannot be given the effect of a notice to the creditor that surety is putting an end to a legal contract of guarantee.[32] In Dhamcomal Parsasen v. Kuppuraj,[33] it has been held that the Indian Contract Act has left it open to the parties to provide as to the manner in which notice to the creditor under section 130 has to be given, then such a contract is binding contract.

When guarantee is given by more than one person, notice must be given by or on behalf of them.[34] A notice revoking a continuing guarantee just a day before the performance of the contract is valid.[35] But it is submitted that the revocation should be within a reasonable time so that alternative arrangements could be made. So far as the revocation of security bonds required by the courts are concerned, the revocation should always come into effect only for subsequent appearances when the principal debtor first has been produced before the court.

Revocation of a Continuing Guarantee by surety's death

Where the guarantee is one which can be ended at the will of the surety while living, it is terminated as to future transactions by his death. But such termination does not affect transactions which were executed prior to his death. Where the contract of the surety is to be responsible for goods to be sold or money to be advanced in the future, it is held to be in the nature of an offer or authority to sell goods or any other authority not coupled with an interest is revocable by notice by the surety to the creditor during life and is ipso facto revoked by his death.[36]

But not all the cases held that death ipso facto revokes the guarantee of future advances even when it might have been revoked by notice during life and there is much authority and reason for the rule that notice or knowledge of guarantors' death must reach the creditor before the credit is given for which the guarantor's estate is sought to be held liable. To the same result is Bradbury v. Margan,[37] " if the guarantee has been in these words," I request you to deliver to A tomorrow morning goods to the value of £ 50, and in consideration of your doing so I will repay you", and before the morning the guarantor died, but the goods were duly delivered, I can see no reason, said Bramwell B, the personal representative of the guarantor should be liable. In that case the guarantee had been acted upon and the question was only as to the effect of the death of the guarantor as to the future advances made subsequently. In such circumstances, at any rate, it is now settled that the death of the guarantor does not put an end to the continuance of the security, unless it comes to the knowledge of the creditor.[38]

The guarantee is revoked by the guarantor's death if the guarantor might have revoked it during his life time. Guarantees have been divided into two classes, one, where it passes wholly in one time- the other, where it passes at different times, and is therefore, separable or divisible. The former are not revocable by the guarantor, and are not terminated by the death of the guarantor and notice of that fact. The latter, on the contrary, may be revoked as to the subsequent transactions by the guarantor, upon notice to that effect and are determined by his death and notice of that event. A leading case on the subject is Lloyd's v. Harper,[39] in this case the principal applied for an admission as an underwriting member of "Lloyd's and pursuant to a rule of that association regarding a guarantee on this behalf. The surety held himself responsible for all his engagements in that capacity. It was held that the guarantee was not terminated by the death of the surety and that the representative of the surety were bound for defaults occuring after his death. Here the consideration is given once for all, just as in the case of granting of a lease in which a third party guarantees the payment of the rent and performance of the conditions. If the surety was at liberty to say, " I withdraw the guarantee", than the guarantee would have been utterly futile and idle.

A similar question was before privy council in S.N. Sen v. Bank of Bengal,[40] in this case the principal was appointed to a office of trust and a contract of guarantee was entered into for securing an appointment of principal in a bank. It was held that there being no series of transactions. It was one transaction, the appointment af the employee to a place of trust in the bank. So long as he continued in that place the guarantee remained and would not be revoked by the death of the guarantor, Any other view would have consequences very injurious to business. It would put the bank in the position of having either to get rid of an official forthwith upon death of his guarantor, which might be most inconvenient, or to keep him without security for his good behaviour. Even where the employee is entitled to three months notice the bank has to take a risk for three months of the guarant..
or's death.

In Kaparthala Estate v. Sheo Shankar,[41] under a security bond, the surety made himself liable to the extent of one year's rent on default by the principal debtor during the period of the lease. The principal died in the course of the lease. The surety did not give notice to the landlord revoking his guarantee. It was held that the surety was liable on the bond for the whole period of the lease.

The general rule is subject to a contrary contract between the parties. The effect of a contract to the contrary is that the death of the surety does not operate as a revocation of a continuing guarantee so far as regards future transactions. In each case, the contract between the parties must be looked into in order to determine whether the contract of surety has been revoked by the death of the surety. If from the contract it can be gathered, either from the express provision or by necessary implication, that there was a contract that the death of the surety would not operate as a revocation, the contract of guarantee will be held to continue even after the death of the surety. In Durga Priya v. Durgapada,[42] towards the end of the bond, it was further stated:

> "Our heirs and legal represenatatives shall be bound by the terms of this security bond in the same way may in which we are bound by them".

From these terms it seems to be clear that the surety bound himself as well as his heirs and legal representatives by the terms of the contract entered into between him and the plaintiff for standing as a surety. There is in this contract as contemplates under section 131 the stipulation that the representatives of the surety would be bound for any act done by the principal debtor during the continuance of his service even after the death of the surety.

There may be two cases where the surety has a contractual right to terminate the guarantee. One is where the contract of guarantee contains a provision enabling the surety to terminate the contract after a certain notice. The other where the surety binds himself and his representatives, after the death of the surety, and also contains a provision that the surety might terminate his liability after giving a certain notice.

In the first, the continuing guarantee is revoked by the death of the surety. In the second case, the death of the surety does not free his representatives from liability for default of the principal debtor subsequent to the death of the surety. In this case the question for consideration is whether there is any contract to the contrary in the surety bond which takes it out of the provisions of this section. If the surety bond shows that it will continue to operate even after the death of the surety or that the operation of the surety bond will continue so long as the original contract between the creditor and the principal debtor continues, the case is taken out of this section and the clause in the surety bond that the surety in the surety bond that the surety can terminate his liability by giving previous notice does not show that the surety can terminate at any time, and, therefore, would ipso facto terminate with the death of the surety.[43]

So far as banks are concerned, the question of notice of determination of the guarantee by the bank is simple no period is required, for the guarantor undertakes to pay the amount due under the guarantee on demand in writing being made by the bank. In protection of its own interest, the creditor should not allow termination on the part of the guarantee, who will be required to give to the creditor a notice in writing of his intention to terminate the guarantee at the expiration of the period stated in the guarantee, which may be, say, one month. This period allows the creditor, on the receipt of the notice, an opportunity of ascertaining the position vis-a-vis the principal debtor and for the guarantor before the expiry, date arrives. In acknowledging the receipt of the notice to the guarantor the creditor will state that the amount of his liability under the guarantee will be advised to him on the expiration of the notice.

In practice, a tri-partite meeting may be sought by the creditor, so that the question of what arrangements the guaranter and/or customer intend to make or repayment or whether the customer can provide alternative security may be discussed among the three interested parties.

REFERENCES

1. Appendix I

2. Wali Md. v. Ganpat, A.I.R. 1931 All. 243; Hasan Ali v. Waliullah, A.I.R. 1930 All. 730

3. Myingyan Municipal Committee v. Mg. PONYUN, A.I.R. 1930 Rang. 173; S.N. Sen v. Bank of Bengal, A.I.R. 1920 P.C. 35

4. ARTHUR ADELBERT STEARNS, The Law of Suretyship, 4th Ed. 1934 P. 70; Hagedorm v. Zenurray 28 Ga. APP 807 (cited in the above book)

5. Chitty on Contract, 24th Ed. vol. 2 para, 4828; Edward W. SPENCER, The General Law of Suretyship, 2nd impression 1913 O. 130

6. Indian a Bicycle Co. Tuttle, 51 Atto Rep. 538; Eastern Bank Ltd. Parts services of India Ltd., A.I.R. 1986 Cal. 61; Rowhatt on the Law of Principal and surety , 4th Ed. 1982 P. 51 where it has been observed:

   A guarantee for a future debt may either be restricted to a debt of that amount to be incurred once and for all, or it may be continuing. The construction will turn upon the wording of the individual contract, the principle being that the guarantee is continuing, unless it either appears that only dealings to the extent of the limit, which are them to cease , are contemplated, or the guarantor distinctly limits his undertaking to a definite transaction or to the first items of the credit amounting of the total named.

7. Ibid.

8. Supra note 3

9. A.I.R. 1920 P.C. 35

10. Bent v. Hartshorn, 1 Met (Mars) 24; Seewalal 1, Fazle Husain, A.I.R. 1939 Nag. 31; Nedeengadi Bank Ltd. v. Dorakiannu Amual, A.I.R. 1941 Mad. 382

11. Guard v. Stevens, 12 Mich. 292, cited supra note 5 The remarks of the court in this case would seem to apply also to the guarantee, " please let my daughter have what goods she wants, and I will stand good for the money to settle the bill. You will find the pay part all right with her, I think". Yet the Court construed this to be a continuing guarantee in Wright v. Griffith, 121 Ind. 478.

12. Mitchell v. Philles, A.I.R. 1931 P.C. 224

13. A.I.R. 1942 Mad. 101

14. Supra note 2

15. 2 Wms Sawmd 813. Refered by Decylor; Benford v. Iles, 2 B & Ald. 43

16. 2 B & Ald. 43

17. Aagero v. Keen, 1 M & W 390

18. S Killett v. Fletcher, L.R. 2 C.P. 469

19. 10 Exch. 77

20. 2 Camp. 413

21. Rowlatt on The Law of Principal and Surety 4th ed. 1982; Supra note 5 P. 59

22. Offard v. Davis 12 C.B. (N.S.) 748

23. (1880) 16 Ch. D. 290

24. Sherumal v. Greenfield, A.I.R. 1930 Sind. 316

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32. Bhikabhai v. Bai Bhuri I.L.R. 27 Bom. 418

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43. Supra Note 27

CHAPTER - IV

SURETY AS A FAVOURED DEBTOR -- ITS ECONOMIC RATIONALE , EXPLANATIONS AND EXCEPTIONS

Surety is a favoured debtor in Law.[1] This observation contains the substance of the liability of the surety vis-a-vis the principal debtor in relation to the creditor. The law of the guarantee though fairly well settled in its main principles has many unusual features and special rules have been evolved with respect to the creation and discharge of a surety's liability. The very nature of the contract of guarantee and the fact it involves three parties, each of whom stands in a different, position vis-a-vis the others, necessarily give rise to diverse juristic interests which the law has endeavoured to adjust. The question arises what is the nature and measure of the liability of the surety.

It has to be noted that the contract of guarantee contains three contracts.[2] One between the principal debtor and the creditor and the other between surety and the creditor and the third between the principal debtor and the surety. Thus what is known in contract as a composite contract of guarantee can be classified into three broad divisions as stated above.

Under the principles of law of guarantee, the surety is liable to the creditor. Because the creditor has entered into the contract in considera- tion of surety's assurance about the performance of the contract by the principal debtor. However, his liability is a qualified one which makes him a favoured debtor to the creditor.

The following are the fundamental reasons which justify the maxim that a surety is a favoured debtor in the jurisprudence of the law of guarantee:

(1) Under section 126 of the Indiab Contract Act, a contract of guarantee is a contract wherein the liability of the surety arises in case of the principal debtor's default. This raises the nice legal question whether the creditor can file a suit directly and exclusively against the surety without having first made the demand or involving the principal debtor.

Under section 128 the liability of the surety is co-extensive with that of the principal debtor and unless there is a contrary contract the suit against the surety without first exhausting the remedies against the principal debtor could be maintained.[3] The creditor can bring a suit against the surety alone or can recover the decretal amount by proceeding against the surety alone in the first instance in execution proceedings.[4] The law has been stated by the Supreme Court[5] that in the absence of some special equity the surety does not have the right to restrain an action against him by the creditor on the ground that the principal is solvent or that the creditor may have relief against principal in some other proceedings. The liability of the surety arises immediately on the failure of the principal debtor to perform their obligation and that the liability is not deferred until the creditor exhausts his remedies against the principal debtor. But the surety is a guarantor, and it is his business and not that of the creditor to see that the principal pays. Before payment, the surety has no right to dictate terms to the creditor and ask him to persue his remedies against the principal in the first instance.[6]

Whether or not demand is necessary before a suit can be maintained against a surety depends upon the construction of the contract. Where the debt guaranteed by the surety is under the terms of the contract payable only after notice of demands, the surety's liability arises only after such notice.[7] The use of the words "unless it is otherwise provided by the contract" in the section is sufficient to warrant the proposition that where the terms of a bond require that the debtor should be proceeded against first, creditor must first take the steps against the principal debtor and if this has not been done no cause of action comes into existence against the surety.[8]

But the position would be different where the bond provides if the aforesaid person fails to pay the amount thereof I will pay it in accordance with the bond". All could be made liable concurrently.[9] In Ram Sagar Singh v. Yogendra Narain Prasad Singh,[10] the surety objected to the principal claim in execution by a creditor first instead of the debtor and where no steps were taken by the creditor to realise the claim from the principal debtor, it was held that the defence of the surety was not maintainable. It was observed by the High Court that it is open to the surety to proceed against any or both of them and as such the execution was maintainable. It would have been different if there was a contract between the parties that in case of default, the creditor should proceed first against the principal debtor and if not satisfied then should have recourse against the surety.

Thus the liability of surety is contingent and secondary. It is not independent and primary. The surety becomes liable only and to the extent of the default of the principal debtor and no more. This enables the surety to be called a favoured debtor in law.

It has again to be noted that the liability of the surety is to the same extent as the liability of the principal debtor to the creditor under the terms of the contract of guarantee.[11] This statement is, however, subject to the contract to the contrary. This gives the surety a power to limit his liability so that he may not be to the same extent to which the principal is liable.[12] This situation is clear if we refer to the illustration attached to section 128. The guarantee may be co-extensive with, or broader or narrower than, the contract between the creditor and the principal debtor. But as a general rule the liability of the principal debtor, unless a smaller or a greater liability is assumed by the surety. A surety may limit his liability to a part of the debt er obligation. This may happen by limiting the liability of the surety in two ways. He might say " I will be liable for a portion of the amount which B shall owe you' or he may say, "I shall be liable for the amount B shall owe to you, subject to the limitation that I shall not be asked to pay more than a certain limited sum [13]. In Re Sass Vaugham Williams, J., observes:

> " Where under the terms of guarantee the surety becomes a surety for the whole amount of the debt, although his liability is limited to a specified sum and has paid that sum to the creditor, the creditor is nevertheless entitled to prove in the bankruptcy of the debt, without deducting thereform the amount received by him from the surety. It makes no difference whether the payment was made before or after the date of receiving order. But where the surety is surety for a part of the debt, as between the principal creditor and the debtor, the right of the surety (to stand protanto in the shoes of the creditor) arises merely by payment of part, because that part, as between him and the creditor is the whole purpose of the guarantee".

In all such cases, what each particular guarantee means is a question of construction. In guarantees for the payment of debts, there is nothing to prevent a surety from limiting his liability, or making it contingent upon some event other than the default of the principal debtor in payment of the debt. Where a surety bond undertakes liability to the extent of a particular sum, but the creditor supplies goods exceeding that amount, the term in the bond does not impose a limit on the creditor advancing any sum but it only imposes a limit on the liability of a surety, and as such the surety is not discharged but is liable to the extent mentioned in the bond.[14] The surety like any other contracting party, cannot be held bound to something for which he has not contracted.

It has also been said surety is a favoured debtor. He is entitled to insist upon a rigid adherence to the terms of his (surety's) obligation by the creditor, and cannot be made liable for more than he has undertaken, for, though his contract is not unlike that of insurance, uberrimae fidei, it must be construed strictly.

A surety being a "favoured debtor", is entitled to insist upon strict interpretation of the bond. His liability is strictissimi Juris.[15] Lord Westbury L.C. in Blest v. Brown,[16] stated this liability in the following words:

> "It must always be recollected in what manner a surety is bound. You bind him to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him. He is bond, therefore, merely according to the proper meaning and effect of the written engagement that he has entered into ..."

According to the rule of strictissime Juris as a general proposition a surety or guarantor is a favorite upon the strict terms of his undertaking. Once the scope and meaning of these terms are ascertained. To the extent, and in the manner, and under the circumstances pointed out in his obligation he is bound and no further. The reason of this rule is found in the fact that his undertaking is often entered into gratuitously or for a mere nominal consideration and as an act of friendship or accommodation, and is onerous and burdensome.[17]

Under the law the guarantor or a surety cannot be held liable for more than he undertakes. However there are some exceptions to this rule. Therefore the cardinal rule remains unfettered that a guarantor or surety must not be made liable beyond the terms of his engagement. The exceptions are, (1) that when there is an ambiguity and all other rules of construction fail the courts should interpret contra proferenten (against the guarantor) or use the recital to control the meaning of the operative part where it is so possible; (2) that while construing a surety bond, the court must consider the object and purpose of its execution and the construction should not be unduly strained as to result in defeating the essential purpose of the bond.[18]

The better and practically universal modern opinion is that the words used in such contracts should be construed the sameway as the words used in other contracts, reasonably and with a view to ascertaining the true meaning and intention of the parties and that the same rules should be applied as in ascertaining the meaning of the language employed in other cases of doubt and dispute.[19]

The surety is not liable upon any implied engagement where a party contracting in his own interest might be and has the right to insist onthe strict performance of any consideration for which he has stipulated, whether the others would consider it material or not and the contract is not to be extended to any other subject, to any other person, or to any other period of time there is expressed or necessarily included in it.[20]

Under the law of contract of guarantee as a general rule, the liability of the surety arises from the liability of the principal debtor. If, therefore, the fountain head of the liability of the principal debtor is chocked and does not spring of at all so does the liability of the surety. In other words as the obligation of surety according to our law - an obligation accessary to that of a principal debtor, it follows that it is of the essence of the obligation that there should be a valid obligation of the principal debtor, consequently if the principal debtor is not obliged, neither is the surety, as there can be no accessary without a principal obligation.

The principal traces its origin from Roman law under which there was a relation of fidejussio similar in substance to that of surety in our law. Fidejussio required that the liability of the surety and the principal debtor should be co-extensive and of the surety's liability were greater than that of the principal debtor the transaction was rendered void for all purposes on the ground, as Henter says, that the obligation is only accessory to the principal obligation and there cannot be more in the accessory than is in the principal.

As a corollary to the above, the liability of the surety has been regarded as conditional upon the principle's liability. As De Colyar observes it "whatever extinguishes the principal obligation determines that of the surety, whose liabilities are in law dependent upon those of hisprincipal so that when the latter cease the former do so likewise." [22]

This provision though does not provide any additional favour to the surety nevertheless absolves the surety from any liability. The cases have occured where an agreement was made by the minor to perform a contract, the surety had undertaken the responsibility of the performance of the contract by the minor. The question in such case is whether the surety of the minor is responsible.[23] The majority view thus is an exception to the rule that the surety is a favoured debtor in law.[24]

The surety enjoys a number of rights under sections 134, 135, 139, 140, 141 and 143.[25] Under these provisions the surety is discharged from his responsibility either totally or to an extent permissible in law. The ways in which the surety is discharged from his suretyship are numerous, for a surety is a 'favoured debtor'. Speaking generally, however, under the law of principal and surety, a creditor must not either act, in a manner inconsitent with the contract of guarantee itself, or do anything to pre-judice the right of contribution, for should he do so, the surety will be released either wholly or protanto. Thus if the creditor has released or destroyed the security which the principal debtor had given to him for the transaction, the surety is relieved of his liability to the same extend.

Under the chapter on guarantee there can be more than one surety for the transaction. Under the law the surety can have the benefit of the suretyship contract which the other sureties had entered into with the (common creditor). This will reduce the liability of each of the co-sureties whether or not he knew about the suretyship contract relating to the same transaction.

Although the Roman Law rules to which reference has already been made are valuable basic principles in a jurisprudential sense, they nevertheless are misleading from the stand point of modern contract law because they fail in general application and are subject to both real and apparent exceptions. The main important exceptions. to the rule that the surety is a favoured debtor may be stated as follows:

<u>Voidness</u>

Where the liability of the principal debtor is void abinitio. This situation arises where by reason of some incapacity or disability in the principal debtor, his contract with the creditor fails to be binding. Thus a surety who bound himself in respect of a contract made by a minor which was void under law, was held to remain liable on the instrument of guarantee, he being regarded in effect as a principal debtor and the contract as one of indemnity.

"A difficulty arises where a person purports to become surety for one who is under a disability. That this circumstance, where there is no fraud or misrepresentation, does not prevent the so-called surety from being liable to the creditor, seems clear. In nearly every instance it will be found that the proper inference, from the facts, is that the intention of the parties was that the socalled surety should be liable as a principal debtor,i.e. whether the principal could be liable or not cases are, however, conceivable where the liability would be more properly explainable as that of a surety by estoppel".[26]

This view leaves unresolved the question whether a guarantor is liable where the accessory contract is in truth a gurantee and there is no room for the operation of an estoppel. This is by no means an inconceivable situation. It will, for example, usually be the case if an undertaking to guarantee the debt of another is given by some one who was unacquainted with the debtor and unaware of the circumstances under which the principal obligation was created.[27]

In the second line of authority the court has to consider the enforceability of the guarantee given by disectors in respect of ultra-vires transactions of their companies. In Chambers v. Manchester and Milford Ry.Co.,[28] Blackburin J. assented that directors who had guaranteed an ultra-vires loan by a bank to the company were liable to the bank. In Yorkshire Railway Waggon Co.V. Maclurc and Carnwall Minesals Ry. Co.[29] Kay J. concluded his judgment by observing:

> "Probably the very reason in this case requiring the guarantee was the doubt that existed whether the company could be compelled to repay. I asked for authority on this point but none was cited. I must therefore decide that the guarantors are liable upon their guarantee."

In the Supreme Court of New South Wales Jordan,[30] C.J., has suggested a distinction which may be sound. He pointed out that the language of the contract and the surrounding circumstances may justify an inference of an implied representation by the promisor that the company has a power to borrow, which would stop him from disputing the existence of a primary obligation. If the company had a limited borrowing power, the contract might be regarded as restricted to the basis made within the limits of the power. OR, the language might be such as to show an indication that the promisor should be liable whether the company incurred the liability or not, so that the contract was in strictness a principal contract of guarantee. Garrard James seems tǿ be the case of this type.[31]

Another explanation is that the ultra-vires rule is a privilege, which is intended to protect, the company, but not third parties.[32] The difficulty with this interpretation is, however, that it appears to conflict with the rule laid-down in 1875 in Ashbury Railway Carriage and Iron Co. v. Riche,[32] that an ultra-vires transaction is a naullity and incapable of ratification even by unanimous consent of all the shareholders. At the sametime there appears to be sound policy reasons for imposing more onerous obligations on directors who so often are able to avoid debts by the device of incorporation. Moreover, it can justly be said that directors are more likely to be acquainted with the powers of the company than third parties. So in the case of company's ultra-vires acts there is every justification, both morally and legally, for holding directors of a company liable on a guarantee given for a company's contract which is ultra-vires, because in actual practice they are more likely to be cognisant of the company's powers and the consequences of its acts than is a person who enters into a contract with the company without consulting its memorandum of association. The potential area of operation of this exception is, of course, severely curtailed by section 9 of the European Communities Act, 1972 which provides that in favour of a person dealing with a company in goodfaith, any transaction decided on by the directors shall be deemed to be one which it is within the capacity of the company to enter into. No doubt each of the decisions constitute an attempt by the respective courts to adjust the conflicting interests of creditor, principal debtor and surety in a fashion which will achieve a fair measure of justice in the particular circumstances and commandable as this may be from many view points, it has unfortunately infused a measure of uncertainty into an important branch of the law.

Leaving aside the possible future recognition of a rule holding a guarantor liable where he furnished a guarantee knowing or suspecting that the principal obligation was a nullity, it is suggested that the two lines of authority discussed above, and the resultant academic discussion, illustrate the relativeness of the liability of a guarantors and a debtor. It would seem that the policy considerations motivated the recognition of an exception in the case of directors guarantees and operated against the admission of a further exception in the case of guarantees given in respect of credit extended to minors. Generally it can be said that where a principal obligation is rendered void by the provisions of a statute, the gurantor will be discharged unless the statute expressly or by implication provides that the sanction of nullity should operate only in favour of the debtor. Such an implication may arise from the language of the statutes or from a consideration of the broad policy consideration underlying it.[34]

Bankruptcy or Liquidation of debtor

The bankruptcy of an individual debtor results in a release of the debtor. But it is now provided by bankruptcy legislation that an order of discharge in bankruptcy will not release any person who was surety for the bankrupt.[35] Prior to the statutory provisions being made to this effect it had been held that the bankruptcy of the principal debtor would not release the surety.[36] The basis for holding that the liability of the surety continues where the principal debtor becomes bankrupt is that bankruptcy merely releases the principal debtor personally and transforms the creditors rights against him into rights against his assets. In Insurance Office of Australia,Ltd. v. T.W. Burke Pvt. Ltd.,[37] Jordan, C.J., gave the reasons as:

> "There is no reason to attribute to the legislature, when it releases or provides for the release of a bankrupt principal debtor, an intention to deprive a creditor, who will otherwise go unpaid to some extent or perhaps entirely, of course against the guarantor whose obligation he has been prudent enough to obtain".

It is submitted that the rationale of the rule is more simple. The principal debtor's possible inability to perform the principal obligation is the creditors motivation for asking for a guarantee and the guarantor's for giving it. The law could, therefore, never countenance that a creditor should "Lose the benefit of the guarantee at the very moment he most needs it".[38]

Just as the bankruptcy of an individual does not discharge a surety from liability, so the liquidation and dissolution of a company does not release a surety for that companys obligation. The only direct authority for this proposition is Re Fitz George, ex P. Robson,[39] the guarantee in this case was for regular payment of interest until the principal sum of a debenture was repaid; since there was not repayment, because of the liquidation and dissolution of the principal debtor (company), the surety's liability became absolute and independent of the principal's obligation.

Statute of Limitation

Where the principal debtor's liability becomes barred by virtue of the Statute of Limitation there is no extinction or release of the principal obligation although the principal debtor is beyond reach of the law. It has accordingly been held that the surety remains liable on his contract of guarantee because the creditor has committed no positive act releasing the principal debtor but has merely neglected to sue him within the period required by the statute, though irrecoverable, is still due.[40]

The liability of the surety as laid down in section 128 is co-extensive with that of the principal debtor, unless otherwise provided by the contract between the parties. This section only explains the measure of surety's obligation where the terms of the contract do not specify otherwise and has nothing to do with extinction by the operation of the statute of limitation. It only means that surety is liable for whole of the amount for which the principal debtor is liable, but not anything less or more than that unless otherwise provided in the contract. It does not, therefore, follow from the wording of the section that the surety gets discharged whenever an action does not lie against the principal debtor because the action against the principal debtor was barred by limitation.

Under section 135, a promise not to sue the principal debtor discharges the surety, the underlying principle of suretyship being that the rights of the surety are not interfered with behind his back to his prejudice. However, mere forbearance or delay in suing the principal debtor or pressing him for payment does not discharge the surety, as these words are expressly used in section 137. Section 137 read with section 134, therefore, will lead to a serious controversy. Again according to section 134 if the creditor, is guilty of any act or omission the legal consequences of which is the discharge of principal debtor, the surety is also discharged. Thus if section 134 is alone taken into consideration, the surety will be treated as having been discharged. But mere forbearance to sue does not discharge the surety within the section 137.

The above provisions have been interpreted by the courts differently. One view[41] is that a failure to sue the principal debtor until the debt is barred by the limitation does not operate as a discharge of the surety. This view is supported by the Privy Council also.[42] But there is also a contrary view.[43] This controversy was however at lost resolved and finally set at rest by the Supreme Court in Bombay <u>Dyeing and Manufacturing Co</u>. v. <u>State of Bombay</u>.[44] Wherein it was held that a creditor is entitled to recover the debt from surety even though the suit against the principal debtor is barred by limitation.

The liabilities of the principal debtor and the surety are distinct though their liabilities arise out of same transaction. An acknowledgement by principal debtor does not save the limitation against the surety, unless it is shown that the latter allowed himself to be represented by the person who made the payment.[45] Likewise it was held that an acknowledgement by the surety does not save limitation as against the principal debtor.[46]

In the result, it is clear from the above discussion that liability of the surety although is said to be co-extensive with that of the principal debtor or that the surety is favoured debtor, it has no relation in so far as its extinction under the Limitation Act is concerned and as such he is liable to pay the debt, notwithstanding the fact that such debt is barred by limitation as against the principal debtor, provided it is otherwise enforceable against the surety.

Contracting Out

The creditors and especially the banks strengthen its own position by the insertion in the guarantees of various clauses whereby the guarantor renounces his legal rights, enshrined in the statutory provisions.[47] As postponement of the surety's right of proof in the bankruptcy of the principal debtor and his right to any security held by the bank until the bank has been paid in full, and his acceptance of the bank's statement of the extent of his liability as conclusive evidence thereof. The most important clause is one in which the bank takes the power to release or modify securities, renew bills, grant time, discharge or vary arrangement etc. with the principal debtor without the consent of the guaranter and without in any way prejudicing or diminishing the validity of guarantee. In Central Bank of India v. B.K. Nayar,[48] it was contended that the guarantor agreed, that he shall not be entitled to any of the rights conferred on securities by sections 133, 135, 139 and 145 of the Indian Contract Act. The validity of the waiver was not decided by the Court. But very recently the Karnataka High Court in R. Lilavate v. Bank of Baroda,[49] was called upon to decide whether the parties can contract out the rights and liabilities laid-down in section 141 by virtue of a contrary contract. It was held that the Contract Act has created rights and liabilities. But the parties have got a right to contract out of the rights and liabilities mentioned in the contract. Therefore, merely because we do not find words notwithstanding anything contained to the contrary etc. in section 141 of the Contract Act. In this case the surety has agreed that she will not claim the benefit given to her under section 141 of the Contract Act. She herself is a party to that surety bond. Therefore it is not open to her now to contend that the said clause is either bad at law or is not enforceable.

Again in B.S. Patsa v. State Bank of India[50] the guarantee bond read as under:

> We/I agree that no failure in requring or obtaining the said security or in the observance or performance of any of the stipulations or terms of the said agreement and no default of the said bank in requiring or enforcing the observence or performance of any of the said stipulatiogs or terms shall have the effect of releasing us/me from our/my liability or if prejudicing the said bank's right or remedies against us/me under the said promissory note.

The bank sought recovery of the amount of Rs. 4,995.61 paise which included stipulated interest. The surety claimed that he had informed the bank urging it to take immediate steps for recovering its due because of the clandestine conduct of the principal debtor. He asserted that despite his second intimation to the bank a few months thereafter, the bank has not taken the steps to protect the security, which enabled the principal debtor to dispose of his stock.

The Court held that the surety was not relieved of his liability under section 137, 139 and 141.

It is submitted that the above view is not sound. Because how a party can surrender his legal rights provided in the statutory provisions, unless those are made subject to a contract to the contrary or in accordance with the policy of the Act. Secondly, section 128, only explains the quantum of a surety's obligation when the terms of the contract do not limit it, and that section has no reference to the nature of the obligation of the principal debtor,[51] so far as the question of the nature of the liability is concerned, other sections are to be taken into account.

Bank Guarantee

There have been a number of cases where the courts have said that the liability of the surety will arise as soon as 'demand' has been made by the creditor without determining the question of liability of principal debtor. A large number of cases of High Courts and the Supreme Court have appeared on the subject.[52]

The liability of the surety under a bank guarantee arises irrespective of the considerations or failure of the original contract. Although the guarantee contract comes into being on account of a provision in the original contract. Such a bank guarantee is fused with autonomy of its own without recourse to the underlying original contract and the bank has to honour its obligations as per the bank guarantee. The obligation of the bank (surety) is absolute and irrevocable on demand for the payment of the guaranteed amount.

It is, therefore, clear that the expression that surety is a favoured debtor has no application in case of a bank/ performance guarantee.

A review of the some of the situations in which a guarantor's liability is not co-extensive with that of the principal debtor showed that the courts have treated such cases as exceptional, thereby emphasising the existence of the general principle. However, it also became apparant that the exceptions to the general rule are not insignificant in number and importance. It is not easy to find out a common thread in the exceptions. It would for example, be stretching these concepts beyond breaking point to say that the voidness of a hire-purchase agreement, which is the subject matter of a guarantee, is a vitiating element attaching to the principal obligation, but, the ultra vires character of a transaction which is subject matter of the director's guarantee, is a defence personal to the debtor. The grounds upon which such exceptions have been admitted are based on policy, considerations, the realities of the situation and equitable consideration as between creditor and guarantor.[53]

These exceptions on a logical analysis depend on fine distinctions such as the differences between void and illegal contracts, between extinction and unenforceability of an obligation. It should be understood, however, that judicial approach to the problems posed by the cases has not been on this basis but rather on the basis that the general rule should release the surety unless there is some countervailing factor or interest which compels the court to hold the contrary. Thus where the bankruptcy or liquidation of the principal debtor intervenes the law attempts to strike a balance between the security of the transaction, the creditor's right to payment and the surety's right to release from liability; the countervailing interests of the creditor and of the public in the security of the contract prevail - as the policy of the bankruptcy legislation requires, over the interest of the surety. Where the Money Lenders Act invalidates or renders unenforceable a loan of money-the policy of the legislation which is designed to protect persons dealing with money lenders - whether principal debtors or sureties is given effect by holding that surety is under no liability.

On the other hand where the principal is a company borrowing beyond its powers the directors who guarantee repayment cannot take advantage of their ultra vires act and are rightly held liable by anology to the doctrine of equitable estoppel. So, too, where a debt is statute barred this has not been allowed to prevent the complete performance of the transaction by obliging the surety to pay the creditor and then seek reimbursement from the principal; for in this way the contractual rights and obligations of all parties are satisfied and honoured.[54]

It can fairly be said that there has been no rigid application of the general rule that the surety is a favoured debtor, modifications have been made and exceptions created by the courts, to adjust the conflicting interests of creditor, principal debtor, surety and also the public interest in favour of the enforcement of contractual obligations formally assumed.

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6. Arumughan Chettiar v. Sadarivam Pellai, A.I.R. 1971 Mad. 321; Mahosah v. Sita Ram Sah, A.I.R. 1962 Pat. 405

7. Harjemal v. Krishna Rao, I.L.R. 5 Bombay 647

8. Radha Krishna Das v. Ajodhea Das, 1937 A.L.J.1265

9. Nand Lal v. Surajmal Gangaram , A.I.R. 1932 Nag.62

10. Supra note 4

11. Ibid., at p. 241

12. Dalchand v. State of Rajasthan, A.I.R. 1976 Raj. 112

13. (1896) 2 Q.B. 12; Phillips v. Mitchell (1930) 57 Cal. 764

14. Haji Moosa Said and Brothers v. Abdul Kareem, A.I.R. 1937 Mad. 360

15. Supra note 1; Sulochan v. State , A.I.R. 1984 A.P. 173; M.S. Anirudhan v. Thomco's Bank Ltd.(1963) 33 Camp. cases S.C. 185; Mohammed Ehiya v. Valliappachattar, A.I.R. 1936 Mad. 576; Pratap Singh v. Keshav Lal, A.I.R. 1935 P.C. 21

16. (1862) 45 E.R. 1225

17. Nicalson v. Paget , 5 C & P. 395

18. Chittoranjan Banerjee v. Dy. Commissioner of Lakhimpur, A.I.R. 1980 Gau., 211 (F.B.)

19. The General Law of suretyship, Edward Spencer Second Impression, 1913

20. Barnes v. Baerow, 16 N.Y. 39

21. Roman Law, 2nd Ed. P. 571

22. Treatise on Law of Guarantees and of Principal and Surety , 3rd ed. 1897.

23. The decided cases on the subject have been discussed in chapter II of the thesis.

24. Morioibi v. Dharmdas Gosh

25. For a Full Discussion of these sections See Chap.V of the thesis.

26. The Law of Principal and Surety , 3rd Ed. p. 7

27. For Full detail see Chapter- II of the thesis.

28. 5 B. & S. 588

29. (1881) Ch. D. 478, Gerrad v. Jaimes and another (1925) 1 Ch. 616

30. Jowitt v. Callaghn (1938), 38 S.R. (N.S.W.) 512

31. Supra note 26

32. E.J. Cohn - validity of Guarantee for debts of Minors , 10 M.L.R. 40 (1947)

33. (1875) L.R. 7 H.L. 653

34. JOHANSTEN v Guarantees. The Co-extensiveness Principal- The Law Quarterly Review ,vol. 90 P. 246 (1974).

35. Bankruptcy Act, S. 28(4) 1914; Bankruptcy Act Sec. 121 1924 - 1946.

36. English v. Darley, (1800) 2 Cas. 613

37. (1885) 35 S.R. (N.S.W.) 438

38. Moschi v. Lep Air Services Ltd. (1973) A.C. 331

39. (1905) 1 K.B. 462

40. Corter v. White (1883) 25 Ch. D 666

41. NurDin v. Allah Ditta, A.I.R. 1932 Lah. 419; Aziz Ahmad v. Shed Ali, A.I.R. 1956 All. 8 (F.B.); Dass Bank Ltd. v. Kali Kumari; A.I.R. 1958 Cal.530

42. Mahant Singh v. UBAYI;A.I.R. 1939 P.C. 110

43. JANG BAHADUR v. BAS DEO SINGH, A.I.R. 1936 All. 549; Chattar Singh v. Makhan Singh, A.I.R. 1936 Pesn. 20.

44. A.I.R. 1958 S.C. 328

45. Federal Bank of India v. Som Dev, A.I.R 1956 Punj. 21; Diyanu Mal v. Nandu Shah, A.I.R. 1931 Lah. 691; Jaina Pain v. Parmeshar, A.I.R. 1931 Oudh.310

46. Brojendra v. Hindustan Co-op. Ins., A.I.R. 1918 Cal., 707; Azizur Rahman v. Upendra A.I.R. 1938 Cal. 129

47. Infra Chapter VII for full discussion

48. A.I.R. 1985 Pun. & Hary. 161

49. A.I.R. 1987 Kant. 2

50. A.I.R. 1986 Ori. 247

51. Chajju v. Emperor, A.I.R. 1921 Lah. 79

52. Infra chapter VI

53. Johan Sten, Op.cit, p. 266

54. R. Else " is a surety's liability Co-extensive with that of a Principal debtor". The LQR- vol. 68 , P. 371 (1947).

CHAPTER - V

DISCHARGE OF A SURETY

The ways in which a surety is discharged from his suretyship are exceedingly numerous, for a surety is a favoured debtor. Speaking generally, however, under the law of principal and surety, a creditor must not either act in a manner inconsistent with the contract of guarantee itself, or do anything to prejudice the right of contribution between the co-suret es for should he do so, the surety will be released, either wholly or protanto.

A guarantor may be discharged or released from his liability under the guarantee by a subsequent release or agreement, by operation of law, by payment or by performance of the principal debtor obligation or by a breach of the contract of guarantee and it may be stated as a general rule that any act or omission on the part of the creditor in breach of his duty under the guarantee, that increases the guarantor's risk or otherwise injures his rights and remedies, discharges the guarantor from his liability under the guarantee, at least to the extent of the injury so occasioned.

Variance

Indian law provides for the discharge of surety in different sets of circumstances. The surety is discharged when any variance is effected to the main contract between the principal debtor and the creditor. However the variance must be without the consent of the surety. When surety has undertaken liability on certain terms, it is expected that they will remain unchanged during the whole period of guarantee. If there is any variance in the terms of the contract between the principal debtor and the creditor, without the consent of the surety, the surety gets discharge as regards transactions subsequent to such a change. The reason for such a discharge is that the surety agreed to be liable for a contract which is no more there, and he is not liable on the altered contract because it is different from the contract made by him. This principle has been incorporated in section 133 of the Indian Contract Act.[1] This section refers to a contract which consists of series of transactions extended over a period of time. It does not purport to make any change in the law in the case of a contract consisting of a single, transaction.[2]

But what is variation in the contract of guarantee has been the subject matter of judicial interpretation. In N. Sulo Chana v. State,[3] the petitioner's husband (along with some other person) was the highest bidder for some shops. But no licence was granted by the government for these shops, unless a surety bond in respect of the previous year's arrears of Rs. 75,928/- was granted. The wife accordingly stood as a surety for the amount. The court held the surety bond as regarding the arrears, it was not confined to the amount. Merely because the amount of the arrears was not determined and could be different from the above figure did not mean that there was a variation in the contract of guarantee. The correct interpretation, the court said) was that the wife cannot be made liable for any amount over and above Rs. 75,928 but certainly she is liable for that amount, or for any lesser amount. This obviously is the correct exposition of law.

The principle of law on the discharge of sureties is that the surety, cannot be held bound to some thing for which he has not contracted. If the original parties have expressly agreed to vary the terms of the original contract no further question arises. The original contract has gone, and unless the surety has assented to the new terms, there is nothing to which he can be bound, for the final obligation of the principal debtor will be something different from the obligation which the surety guaranteed.[4]

If an alteration is made in a material part of a deed after its execution, by or with the consent of any party there to or person entitled thereunder, but without the consent of the party or parties liable there under, the deed is thereby made void. The avoidance, however, is not abinitio or so as to nullify any conveyancing effect which the deed has already had, but only operates as from the time of such alteration and so as to prevent thepperson who has made or authorised the alteration and those claiming under him, from putting the deed in suit to enforce against any party bound thereby who did not consent to the alteration, any obligation, covenant or promise thereby undertaken or made.

In the field of law relating to the alteration of documents, the strict rule at one time was that the slightest alteration makes the document void. The leading case for a long time was Pegot's case,[5] where

Lord Coke stated the doctrine as follows:

> "These points were resolved, where any deed is raised, whereby it becomes void, the obligar may plead nonest factum , and give the matter in evidence, because at that time of the plea pleaded, it is not his deed". Secondly, it was resolved that when any deed is altered in a point material by the plaintiff himself, or by any stranger, without the privity of the obligee, be it by interlineation, addition,raising or by drawing of a pen through a line, or through the midest of any material word, that the deed thereby becomes void. So if the obligee himself alters the deed by any of the said ways, although it is in wards not material, yet the deed is void. But if a stranger, without his privity, alters the deed by any of the said ways in any point material, it shall not avoid the deed".

The principle as to discharge of surety was stated by Lord Westbury L.C. in Blest v. Brown,[6] in the following words:

> " It must always be recollected in what manner a surety is bound. You bind him to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him. He receives no benefit, no consideration. He is bound, therefore, merely according to the proper meaning and effect of the written engagement that he has entered into. If that written

> engagement is altered in a single line, no matter whether the alteration be innocently made, he has a right to say, the contract is no longer that for which I engaged to be surety, you have put an end to the contract that I guaranteed and my obligation, therefore, is at end."

Material Alteration

A material alteration is one which varies the rights, liabilities or legal position of the parties ascertained by the deed in its original state or otherwise varies the legal effect of the instrument as originally expressed or reduced to certainty some provisions which were originally unascertained and as such void. The effect of making such an alteration without the consent of the surety is exactly the same as that of cancelling the deed. In Lakshman Mal v. Narasinharaghava Iyengar,[7] the Madras High Court held that " an alteration in a document which has the effect of enabling the payee to sue on the document in a court where he could not have sued on it in its original form is a material alteration and as such destroys the right of action on the document".

Where a compromise decree was passed against the debtor providing for the payment of debt by instalments and a certain person stood surety for the due payment of such instalments on the strength of the property that was attached before judgment and subsequently permission to mortgage and sell the property privately was granted to the judgment debtor. It was held that under the circumstances the moment permission was granted to the judgment debtor to effect private mortgages or sales, the whole position was changed and the surety stands discharged on the ground of material alteration.[8] Likewise where a certain partnership, stipulating to be dissolved where losses occur. The firm carries on a business with a certain specified capital. The firm sustains losses and the partners instead of dissolving the partnership, further enlarge the capital and extended the business by amalgamating it with a rival concern. The firm also undertakes another business not originally contemplated. The new changes and liabilities in the business has thus totally changed the character of the business in the original contract of suretyship. This amounts to a material variation and, therefore, the surety cannot be made liable for the losses that may occur in the newly formed business[9] where the variation of the contract has the result of laying an additional burden on the surety, the surety will be discharged. An unauthorised material alteration by the promisee whether that is by adding anything to or by striking out any part of a written contract avoids the contract against the person otherwise liable upon it. In a printed form of guarantee, if the signature of the guarantor is obtained prior to the filling up of the blanks relating to the material particular of the contract, the filling up of the blank spaces in the form of the guarantee amounts to material alteration. In S. Perumal Reddiar v. Bank of Baroda,[10] the plaintiff, the Bank of Baroda was the creditor having advanced Rs. 15,000 as crop loan to the first defendant who was the principal debtor. The second and third defendants were the guarantors. In the printed form the introduction by way of filling up the blank spaces, relating to the date of execution, name of the principal debtor, names of the sureties, the description of the land for which the loan is advanced, as loan, and the rated of interest. It was held that these were material alterations made without the consent of the surety. The surety was, therefore, discharged from his contract of guarantee. The court did not expressly condemn the practice of obtaining signature of a party on blank (printed) forms. But the legal effect of the decision would put the obtainers (of signatures) to serve test of consensus ad idem

(meeting of minds) of which the problem of variation of the deed of guarantee is only an off-shoot.[11] In Rananund v. Choudhey Soonder,[12] where, under a consent decree, it was provided that in the default of one instalment, the properties in suit may be sold, and the surety proceeded against for any deficiency, the privy council held that the decree- holders' delay in actually bringing the properties to sale had the effect of discharging the surety protanto, as to interest due from the date of the order for sale, because the act of the creditor in postponing the sale laid an additional burden on the surety by increasing the interest.

Immaterial alteration

Unsubstantial alterations in an instrument of guarantee which are to the benefit of the surety do not discharge the surety from the liability. An alteration made in an instrument after its execution, in some particular which is not material, does not, in any way effect the validity of the instrument. An alteration is not material, if it carries out the intention of the parties already apparent on the face of the deed. Cotton L. J. stated the Law in Halme v. Brunskill,[13] as follows:

> " The true rule in my opinion is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alterations although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged. Yet that if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court will not in an action against the surety go into an inquiry as to the effect of the alteration."

An instrument is not discharged by an immaterial alteration, that is to say, one which does not alter the legal effect of the instrument or increase a greater liability on the promisor. An unauthorised material alteration by the promisee whether by adding anything to or by striking out any part of a written contract, avoids the contract against the person otherwise liable upon it.

The strictness of the rule was that any alteration without the surety's consent even for his benefit will discharge the surety, tempered in subsequent cases and was departed from in Aldous v. Carnwill,[14] where Lush J. after referring to numerous authorities, observed:

" This being the state of authorities, we think we are not bound by the doctrine in Pigots case[15] or authority cited for it and not being bound, we are certainly not disposed to lay it down as a rule of law that the addition of the words which cannot possibly prejudice any one, destroys the validity of the note. It seems to us repugnant to justice and common sense to hold that the maker of the promissory note is discharged from his obligation to pay it because the holder has put in writing on the note what the law would have supplied if the words had not been written".

The question whether a document jointly executed by the two persons creating a joint liability is to be regarded as materially altered of the liability is reduced equally for both but the alteration is made by only one of them. Such an alteration must be regarded as unsubtantial and not otherwise than beneficial to the surety and it cannot attract the strict rule.

The rule was applied by the Supreme Court of India in M.S. Anirudhan v. Thomco's Bank Ltd.,[16] the facts of the case were that the respondent bank allowed an overdraft of Rs. 20,000 to the principal debtor on the guarantee of the appellant. Originally the guarantee paper showed the sum of Rs. 25,000 which the bank refused to accept. The principal debtor took it back and altered the sum to Rs. 20,000 and gave to the bank. Th e bank brought an action against the surety on the default of the principal debtor. The surety appellant contended that the sum was unauthorisedly altered and, therefore, he was not liable. The Bench consisted of J.L. Kapur, A.K. Sarkar and M. Hidayatullah , JJ. The Supreme Court was devided in this case. It was held by a majority that the surety was not discharged.

As per Kapur J., (as he then was): where a guarantor entrusts a letter of guarantee to the principal debtor and the principal debtor makes an alteration without the assent of the guarantor, then the guarantor is liable because it is due to the act of the guarantor that the letter of guarantee remains with the principal debtor and what the principal debtor did well estop the guarantor from pleading the want of authority.[17] In the same case, Hidayatullah J., (as he then was) said that the particular document, could not be said to have been materially altered, because it had not been altered in such a manner as to change its nature, the alteration does not save the surety from liability arising under it, the alteration was made by co-executant who reduced not only his own liability but that of the surety also. Sarkar J., (as he then was)differed and held, that the altered document was not binding on the surety for the alteration had not been made to carry out the intention of the parties. If the alteration was ignored, then the document created no liability in the surety, because the bank refused to accept the guarantee on the terms contained in the document before it was altered.

It is submitted that the majority view does not appear to be logical interpretation of section 133. The minority view appears to be in confirmity with the provisions contained in section 133. It is submitted with respect that if the bank had handed over the guarantee form to the borrower asking him to get it signed by the guarantor and then return it to the bank, the borrower was acting as the bank's agent. Even assuming that the borrower was acting as the agent of the guarantor, there was no evidence to show that the borrower was authorised by the guarantor to make the alteration. The principle under section 237[18] of the Indian Contract Act, is not applicable on the ground that was the alteration within the apparant authority of the borrower so that the principal was bound by it vis-a-vis the third party, the bank in this case.

It is difficult to think that the apparent authority of an agent who was authorised merely to deliver a guaranteed document to the bank, extended to an alteration of the amount guaranteed. Assuming that the borrower had the apparent authority to alter the amount, the authority of such as would cover not merely a reduction in the amount but an increase also-in other words, any change of the amount. If the amount had been raised, would the learned judge still have held that the surety was bound by the altered amount ?

It should be noted here that the Indian Contract Act which was enacted some year after the Holmes v. Brunskill[19] decision, provides that any varaince made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance. The section 133 makes no distinction between a variation that is to the advantage of the surety and one that goes against him.

The moral is that any alteration in the guarantee should be got duly authanticated by the guarantor. Further as a general rule, the guarantor should be required to sign the guarantee in the presence of an official or officials of the bank. From replies to the questionnaire by various banks this practice is followed. The practice of entrusting the guarantee form to the borrower with a request to get it signed by the guarantor shoudd be discouraged. Once the banks follow this practice a lot of litigation can be avoided between the parties.

Release or Discharge of Principal debtor

A surety is discharged by an arrangement or by a contract between a creditor and a principal debtor whereby the principal debtor is released. Release of the principal debtor also operates as a release of the surety. It has been already noted that the liability of the surety is co-extensive with that of the principal debtor. Therefore, if by any contract between the creditor and the principal debtor the principal debtor is released, or by any act or omission of the creditor, the principal debtor is discharged, the surety will also be discharged from his liability accordingly.

Another reason for the discharge of the surety on the release or discharge of the principal debtor is that according to section 140, after payment or performance of his obligation the surety can seek re-imbursement from the principal debtor. If the principal debtor, is no more liable the surety's remedy would be affected thereby. If surety's remedy against the principal debtor is affected that should also result in the discharge of the surety. The law concerning the discharge of the surety on the release or discharge of the principal debtor is contained in section 134 of the Indian Contract Act.[21]

If the creditor, by any contract with the principal debtor releases him, he cannot place his remedies at the disposal of the surety without a breach of his arrangement with the principal debtor to release him. To carry out that arrangement, the surety should have right to take action against the principal debtor in respect of the debt, engagement or liability. This cannot be done without the surety's consent. He is, therefore, held discharged altogether Likewise, where the surety guaranteed the due performance by the debtor of his obligations under a hire-purchase agreement in accordance with its terms and paid the full amounts due under the agreement, the surety is held to be discharged, even though the hire-purchase company did not receive the full amount it might have expected to receive had the agreement run its full course. Difficulty sometimes arises in deciding whether a performance by the principal debtor discharges him in respect of the guaranteed liability or in respect of a separate obligation which is not subject to the guarantee For example, the principal debtor owes two distinct debts to the creditor, only one of which is guaranteed by the surety, and the principal debtor pays part of the money to the creditor the question may arise as to which debt is discharged. In these circumstances the general rule is that the contract of suretyship does not affect the normal rights which the principal debtor and creditor have of appropriating the payment to a particular debt. Thus if the principal debtor pays without making any appropriation the creditor is entitled to appropriate the money to the debt which is not guaranteed.[22]

An express release of the principal debtor from all future will discharge the guarantor since such release extinguishes the guaranteed debt. This is so whatever the express reservations there may be, except where the principal debtor obtained the release by fraudulent means. However, a mere covenant not to sue the principal debtor with a reservation of the bank's rights against a guaranter, does not discharge the guarantor.

In Kearsley v. Cole, where the principal debtor compounded with his creditors, who covenated not to sue the principal debtor,but the composition was expressed to be without prejudice to any security (which included guarantees) or to any guarantors rights against the principal debtor. One of the creditor's then sued the guarantor successfully, and the guarantor in turn sued the principal debtor. It was held that where the principal debtors, creditors expressly reserve their rights against the guarantor, the guarantor automatically retains his kimplied right to an indemnity from the principal debtor. Even though the guarantor was not a party to the composition, the principal debtors consent for the creditor to have recourse to the guarantor constituted an implied consent for the guarantor to have recourse to the principal debtor and consequently the principal debtor could not complain when the guarantor sought to enforce his rights against the principal debtor.

The reason why the surety is discharged if the principal debtor is discharged is that the courts took the view that any other rule would lead to one or other of two strange results, having regard to the surety's normal rights to an indemnity for the principal debtor.

If the surety were compelled to meet the liability, any attempt by him to sue the principal debtor for an indemnity might be met by the plea that the debt had gone and the principal debtor was no longer liable. If this were a good answer to the surety he would be deprived, by the unilateral act of the creditor,of a right which he would have expected to have. On the other hand, if the principal debtor remained liable to indemnify the surety despite his own discharge, the effect would be to render the discharge nugatory. In the result it is treated that the discharge of the surety as a necessary consequence of the discharge of principal debtor. Whatever may be thought of this reasoning it has been the rule to have no application where the creditor reserves his rights against the surety at the time when he discharges the principal debtor, for this is a sufficient notice to the principal debtor that the surety remains liabbe, and that, therefore, the surety's right to an indemnity remains intact.

Discharge of Principal debtor by operation of law

A surety isliable for the debt, default or miscarriage of the principal debtor. A contract of guarantee means a contract to perform the promise or to discharge theliability of a third person in case of his default. There is nothing in the section to restrict the word default to a voluntary default. Naturally, it should be taken to include an involuntary default. The surety is not discharged by the discharge of the principal debtor by operation of law.[24]

Opinion is divided on the question that where a debt is scaled down, does the liability of the surety extend to the whole of the original debt, or is limited to the reduced amount? The Nagpur High Court has ruled that the liability extends to the whole of the original debt. The court held that "The debt Relief Court proceedings had nothing to do with Balkrishna (the surety) They will hold good as between the principal judgment debtor and the decree-holder by operation of law, but any orders passed therein will not operate in connection with the surety, who was not a party to them.[25] In Keshearao v. Laxman,[26] pollock J. laid down that "The liability of the surety and the liability of the principal debtor are separate liabilities although arising out of the same transaction. Hence, while the application of the principal debtor under the debt Conciliation Act is before the Board, the debt of the surety cannot be said to be a matter before the board". But the Madras High Court has held that the surety is liable only for the reduced amount.[27] It is submitted that the Madras opinion is correct as it is clear under section 128 that the liability of the surety is co-extensive with that of the principal debtor. It cannot be higher than that of the principal debtor. Pollock and Mulla[28] while prefering the view taken by the Full Bench decision of the Madras High Court[29] observed that", the judgment of the Court is, however, remarkable, for the curious interpretation placed upon section 140, and the complete failure to mention section 145. The Court considers that to hold the surety liable in solidum would be injust, as he has no recourse against the principal debtor, in as much as section 140 confines his rights against him to those the creditor has with respect, this is to misread section 140 which is an unabling section, and does not purport to confine the rights of the surety to those possessed by the creditor. The talk of its imposing the burden is a misconception, the right of the recourse against the principal debtor is provided by section 145".

Section 145 gives the surety a right of re-imbursement from the principal debtor. If this is so the debtor has no real relief under the Debt Relief Act whose object is thus defeated on the Madras view, the law is at least clear that the loss caused by scaling down falls upon the creditor. As per the Nagpur view, it is uncertain whether the surety or the principal debtor bears the loss, apparently the latter in the absence of any fresh proceedings under the Debt Relief Act.

The Kerala High Court has expressed its full agreement with the view of the Madras High Court. The Kerala High Court observed:

> " It appears to us that section 128 of the Indian Contract Act states the ambit of liability of the surety when it enacts that the liability is co-extensive with that of the principal debtor. It has nothing to do with the consequences of recovery of the debt. Such being the scope and intendment section we fell that a statutory reduction or extinguishment of the principal debtor's liability will operate as a protanto reduction or extinguishment of the surety's debt. A reduction or extinguishment of the debt is quite different from its unenforceability against the principal debtor by operation of the law of Bankruptcy or the statute of limitation.
>
> It appears to us that to hold otherwise, would altogether deny the benefit of the aneliorative provisions of the Act to the agriculturist-debtor. On any other view, it would be open to the creditor to recover the debt as scaled down from the agriculturist debtor, and the latter in his turn could seek reimbursement from the principal debtor(vide S.145). Such a construction would completely nullify the benefits of the ameliorative legislation to indebted agriculturist". 30

Act or Omission of the Creditor

The acts or omissions of the creditor, which have the effect of discharging the principal debtor, automatically discharges the surety as well . The act or omission on the part of the creditor must be such the legal consequences of which is the discharge of the principal debtor. Such act or omission of the creditor may be those arising under sections 39, 53, 54, 63 and 67 of the Contract Act. Thus the mere fact that the creditor, after having filed a suit against the principal debtor and the surety allows the suit against the former to abate on his death, will not operate to discharge the surety.[31] On the same principle, where the principal debtor by not taking proper steps for service of summons on the principal debtor allows the suit as against him to be dismissed, the surety's liability on the account is not discharged.[32] The reason being that the plaintiff can yet bring a fresh suit against the same person. The Supreme Court has very recently explained the scope of section 134 in M.S.E.B. Bombay v. Official Liquidator, H.C. Ernakulan,[33] and observed:

"The bank cannot take the plea that it is liable to the extent of any loss that may have been sustained by the Electricity Board oweing to any default on the part of the supplier of the goods, i.e., the company in liquidation. The liability is absolute and unconditional. The fact that the company in liquidation also would not have any effect on the liability of the bank i.e. the guarantor. Under section 128 the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. A surety is no doubt discharged under section 134 by any contract between the creditor and the principal debtor by which the principal debtor is released or by any act or omission of the creditor, the legal consequences of which is the discharge of the principal debtor, but a discharge which the principal debtor may secure by operationoof law in bankruptcy does not absolve the surety of his liability".

<u>Omission to sue principal within limitation</u>

Generally, the liability of a surety is made depend upon the liability of the principal debtor. A positive action of the creditor which discharges the principal debtor releases the surety. However, the laxity of the creditor in pressing his claim against the principal debtor may not be pleaded as a defence by the surety, although he thereby suffers a deteriment. Now can a surety plead a defence which is in essence personal to a principal debtor. Likewise can a surety avoid liability on the ground that a debt is barred by limitation as against the principal debtor.

There was distinct cleavage of opinion among the various High Courts on the point that omission by the creditor to sue the principal debtor will or will not discharge the surety. The majority of the High Courts, namely, Bombay[34], Calcutta[35], Lahore[36], Madras[37], Rangoon[38] and Nagpur[39] were of the view that the surety is not discharged. While the Allahabad High Court[40] took the view that the surety was discharged. The conflict has, however, been set at rest by the opinion of the privy council,[41] which accepted the view of the majority of High Courts. The Allahabad High Court[42] also in its subsequent Full Bench decision accepted the majority opinion by over-ruling its earlier decision.

The reasons in support of the minority view were that it is obvious that any act or omission of the creditor, the legal consequences of which is the discharge of the principal debtor, discharges the surety, and mere for-bearance on the part of the creditor to sue the principal debtor does not absolve the surety from the liability. If we were to interpret the plain words of these two statements, we should have no difficulty in coming to the conclusion that the act of the creditor in allowing his suit to be barred against the principal debtor would amount to an act the legal consequences of which is to discharge the principal debtor and, therefore, such act would automatically exonerate the surety from his responsibility. The court also held " we would have no hesitation in interpreting the words ' mere forbearance ' to mean forbearance of the creditor from suing the principal debtor within the period of limitation. The simple reason for this latter interpretation is that a person can only forbear to do a thing as long as he has got a right to do it. Directly the suit of the creditor becomes time-barred, he loses his power to enforce his claim . Forbearance after the expiry of the period of limitation would therefore be meaningless".[43] It could not be conceived for a moment that the draftsman who framed the Contract Act proceeded to undo in section 137 what he had done for the surety in section 134. Moreover we must stress the words Legal consequences in section 134. To relieve the surety, the act or omission of the creditor should be such that its legal consequence would be the discharge of the principal debtor. It clearly includes the omission to sue within the period of limitation because it is purely legal consequence of such omission that the principal debtor is absolved from payment. Again the importance of the word'mere' before the word 'forbearance(shows that the legislature meant a forbearance by itself that is to say, a forbearance which would lead to no serious consequences.

On the other hand the majority view is based on the ground that a debt does not cease to be a debt, because its recovery is barred by the law of limitation. The right subsists, though the remedy comes to an end. Shadi Lal, C.J. observed, that the balance of judicial authority is decidedly in favour of the view, that the omission of the creditor to sue the principal debtor does not discharge the surety".[44]

The controversy has been, however, resolved by the Privy Council,[45] where the judicial committee have affirmed the majority view of the High Courts and observed that the view of the Allahabad High Court[46] is inconsistent with the English Law also. It was held that not every unenforceable contract is declared void but not those unenforceable by reason of some procedural regulation but unenforceable by the substantive law. A mere failure to sue within the time specified by the statute of limitation or an inability to sue by reason of the provisions of one of the orders under the civil procedure code would not cover a contract to became void.

It is submitted that the majority view appears to be in confirmity with justice. The law Commission in its 13th Report[47] suggests that an explanation shall be inserted in section 134 of the principal Act to adopt the majority view. The Supreme Court[48] has also held that a creditor is entitled to recover the debt from the surety even though the suit against the principal debtor is barred. A time barred debt does not become extinguished but only becomes unenforceable in a court of law. If a debt subsists even after it is barred by limitation, in law, there is no discharge therefrom. The modes in which an obligation under a contract becomes discharge are well defined and the bar of limitation is not one of them. If the law requires that a debtor can be discharged before he can be compelled to pay that requirement is not satisfied. If he is merely told that in the normal caurse he is not likely to be imposed to action by the creditor. A barred debt is a valid consideration under sec. 25(3) of the Contract Act for a written promise to pay signed by the party liable to be charged therewith. Equally when section 60 of the Contract Act speaks of barred debt as lawful debt actually due and payable it cannot be considered to be discharged. Surety, as a prudent guarantor, to avoid the risk and the cloth himself with all the creditor's rights under S. 140 of the Contract Act, himself is to pay or perform the obligation within limitation lest he is himself to blame.

Hence by mere failure or forbearance to sue the principal debtor, the surety is not discharged from the liability unless there is an express covenant in that regard or a release by the principal debtor by novation or otherwise. Therefore the ommission to sue the principal debtor by the creditor within the period of limitation does not discharge the surety.[49]

Composition

The word composition means an agreement, or an arrangement, or a compromise. A contract between the creditor and the principal debtor, by which the creditor makes a composition with the principal debtor, discharges the surety unless the surety assents to such contract.

This rule is founded on the principle stated by Lord Laugh borough in Ress v. Bessingtan[50] thus:

> " It is the clearest and the most evident equity not to carry on any transaction without the privity of him who must necessarily have a concern in any transaction with the principal debtor. You cannot keep him bound and transact his affairs (for they are as much his as your own) without consulting him".

When the creditor makes composition with the principal debtor without the consent of the surety this means variation in the original contract. The composition must tend to aggravate the surety's sufferings. The idea underlying S. 135 of the Indian Contract Act, is that where the creditor does something behind the back of the surety, and does to his prejudice , by advancing facilities to principal debtor, which are likely to harm the surety, the surety is no more to be bound by his undertaking. Accordingly a surety who seeks to be relieved of the obligation upon him as surety and to be absolved from liability must not only show that the creditor has, by his acts or conduct, either prevented the principal debtor from doing the things which he undertook to do, or has connived at the principal debtor's omission to do those things, or has enabled him to do something which he ought not to have done, but he must also show that the creditor has done some act inconsistent with the rights of the surety.[51]

The question as to whether a surety is discharged on a compromise being entered into between the judgment, debtor and the decree-holder and a consent decree being passed en such compromise depends on the facts and circumstances of each case and particularly on the terms of the bond executed by the surety in each case. Where, therefore, the compromise is effected without the consent of the surety by which he is seriously prejudiced and where such a compromise was not where such a compromise was not contemplated by the surety, when he executed the bond. A consent decree under these circumstances discharges the surety and absolves him of his liability. However, a mere passing of a consent decree does not absolve the surety because when the surety undertakes to be bound by any decree that may be passed such a recital includes a bonafide compromise which is entered into by the parties without any fraud, but in cases where there is an express recital in the surety bond or by necessary implication by which the liability is restricted only to a decree on contest, the surety will stand discharged if a compromise decree is passed.

The above view is supported by a decision in Trilok Nath v. Kehar Singh,[52] wherein the bond executed by the surety provided that he will be liable only if a decree is passed against all the defendants and if all the defendants are unable to pay the amount. A compromise was entered into whereby the decree-holder absolves all other defendants and restricts his claim only to the principal defendant. It was held that such a contract on the part of the decree-holder is inconsistent with the rights of the surety. It impairs the remedy of the surety against other defendants. The surety stands discharged.

In order to determine whether a surety stands discharged or continues to be liable under the surety bond the real test to apply is to find out the terms of the bond and its scope. Therefore, where there is nothing in the decree which shows that the compromise is at variance with the terms of the surety bond, then notwithstanding the fact that the surety was not at the time of the compromise entered into between the parties to the suit and the consent decree is passed, the surety continues to be liable and does not stand discharged.[53] In Citibank N.A., New Delni v. J.K. Jute Mills Co. Ltd., Kanpur,[54] the Delhi High Court held that the consent decree did not hit the provisions of section 135 and was not a compromise, stemning out of a contract to which the section makes reference. The Court said " It would not make the slightest difference if the decree is consent decree especially in this case when the creditor by way of the consent decree got 100% relief". In fact the consent did not in any way impair or prejudice the right of the defendant surety.

Agreement to give time

It has long been a rule of suretyship that if a creditor releases or extends the time for payment by the principal debtor, or impair the collateral for the debt, knowing of the surety's right of recourse against the other party, and fails either to reserve his rights against the surety or to obtain his consent for the extension or release, the liability on the guarantee will be discharged if the surety should pay all or part of the debt- as he has a right to do at any time after it matured- he then can sue his principal for reimbursement on the theory that the surety was subrogated to the creditor's cause of action.

Therefore, a valid binding agreement between the creditor and the principal debtor to extend time for payment, although affecting only one material element of the existing indebtedness, stripped the surety of his rights to exoneration, reimbursement, subrogation and contribution because the debt simply was not due at the time originally contemplated by all the parties.[55]

Promise to give the time to the principal debtor means extending the period of payment which was not contemplated in the contract of guarantee. The surety expects that the creditor will take the performance from the principal debtor without any delay. A binding agreement between the creditor and the principal debtor to give more time to the principal debtor or to repay his debt will discharge the guarantor from liability if made without his consent, whether or not he is in fact prejudiced by the agreement. The reason appears to be that in theory such an agreement necessarily prejudices the guarantor by preventing him from exercising his right to require the creditor to call upon the principal debtor to pay off the debt or his right to pay off the debt himself, and then sue the principal debtor. Because he himself is the fit Judge of what is or is not for his own benefit. If you agree with the principal debtor to give him time, it is contrary to that agreement that you should sue the surety, because if you sue the surety you immediately turn him upon the principal debtor and, therefore, your act breaks the agreement into which you have entered into with the principal debtor. The point was explained by Smith, L.J. in Rause v. Bradford Banking Co.,[56] as follows:

> " A surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt,or himself to pay off the debt, when he has paid it off, he is at once entitled in the creditor's name to sue the principal debtor, and if the creditor has bound himself to give time to the principal debtor, the surety cannot do either the one or the other of these things until the time so given has elapsed, and it is said that by reason of this the surety's position is altered to his detriment without his consent".

The Supreme Court of India has held that what really constitutes giving of time is the extension of period at which, by the contract between them, the principal debtor was originally obliged to pay the creditor by substituting a new and valid contract between the creditor and the principal debtor to which the surety does not assent. Accordingly where a bank gave time to the principal debtor to make up the deficiency of the goods pledged, it did not tentament to giving of time within the meaning of section 135.[57]

Where a joint decree is passed against the principal debtor and the surety and after the passing of decree, the creditor decree-holder without the consent of the surety, grants instalments to the principal debtor, that amounts to the principal debtor, that amounts to giving time to the principal debtor and the surety is discharged thereby.[58]

An agreement to pay money in lump sum or six instalments is not the something as one to pay it in instalment or ten instalments, if the creditor by a valid agreement with the principal debtor, extends the time of performance from the shorter to the longer time, he supersedes the old obligation by the new, and cannot enforce payment until the longer period has elapsed . If the surety is sued upon the old agreement, to which alone his undertaking was accessory, he has only to show that has ceased to exist, and no longer binds his principal debtor and if he is sued upon the substituted agreement, he is entitled, both at law and in equity to make the short and conclusive answer non hou in foredera veni. The agreement extending the time of payment or performance must be valid and enforceable by the principal debtor in order to affect the surety's liability, and if it be void for want of consideration or for illegality or is voidable because of fraud or undue influence practiced upon the creditor or if for any other cause it is insufficient to say the hand of the creditor as against the principal debtor, the surety is not released. The time for which the extension is granted to the principal debtor without the surety's consent must be definite and fixed,otherwise the surety is not discharged. The reason for this rule is that if no definite time is fixed, the surety may pay the debt and proceed against the principal debtor at any time after its maturity.

Reservation of Right

But any binding agreement between the creditor and the principal debtor, extending the time of payment or performance for any period, however,short, entered into without the consent of the surety will release the surety. Unless the creditor reserves his rights against the surety. The reason being that nor does the extention constitute a material alteration or variation of the contract, so that itis no longer the surety's undertaking, but it deprives the surety of the right to pay the debt when it is due according to the original contract or at any time thereafter and there upon enforce his rights of indemnity and subrogation.

In Annadanajadaya v. Konamma,[59] the Madras High Court observed:

> "If a creditor agrees to discharge the principal debtor it would be breach of the agreement to entered into for the creditor to pursue his remedy against the surety, for the latter would in his turn enforce his remedy against the principal debtor, and thus the creditor's agreement to discharge would be rendered inoperative, but if the very agreement to discharge the principal debtor contains a reservation of rights against the surety, the agreement cannot operate as absolute release for the obvious reason that the principal debtor has notice that the creditor's remedy against the surety is preserved and that the latter's right of recourse against him is not extinguished".

The early development of the right of reservation grew outof an unreported English opinion, Richard Burken's case, which involved an action by a creditor against a co-surety after the former had given an extension of time to the principal debtor Lord Thur-Law in Burken's case, suggested, by way of dictum, that the surety was released only if he were denied remedy against the principal debtor and that if the creditor had reserved his rights against the surety, the action would have been successful for them the surety would have had recourse against the principal debtor.[60]

The orthodon rationale advanced by the Courts to upheld the reservation clause in either extension of time or release is premised onkhthe assumption that, in as much as the principal debtor has specifically agreed to accept a conditional release from the creditor, he thereby impliedly agreed that the surety's right to reimbursement should not be impaired. Thus he cannot complain if the surety, after fulfilling his obligations to the creditor, seeks redress from him. The reason for the existence of these rules were criticized. Coheridge J. disliked it so much that he would have passed long before upholding any such rule; but he was bound by the authorities that established. The reason why this should prevent the release of the surety is difficult to understand. It is said that by reserving the rights the principal debtor agrees that the surety could go against him, the securities are intact, the remedy is gone between the creditor and the debtor, in as much as the creditor cannot sue the debtor but as against all other persons the rights of the creditor are reserved.[61]

The most serious objection to the rationale offered in support of reservation clause is that it ignores completely the principal debtor's purpose of entering into the transaction. Literally interpreted, the agreement unqualifidely absolves the principal debtor from the performance of his former obligations to the creditor, if the reservation has the effect of merely forcing the creditor to send another collector after the principal, the value of the particular agreement to the principal debtor would to a large extent be destroyed.

It has been said that when the principal debtor obtains a release from the creditor, he is defrauded if the creditor is allowed to collect from the surety, who in turn will collect from him, and that the surety must be released. Conversely, if the principal debtor consents to a reservation of rights against the surety he impliedly consents to this indirect enforcement of the released obligation. This argument, however, rests upon the doubtful premise that the principal debtor did not consent to this circuitous enforcement when he was released without reservation of rights.[62] This view is also supported by professor Arant as he pointed out, the parties contracted with reference to performance by the principal, and since the agreement between the principal and the creditor makes non-performance by the principal inevitable, such was clearly not within the contemplation of parties, and imposes upon the surety an entirely different risk than that which he assumed.[63]

In addition, the simple expedient of the reservation clause effectively nullifies the rule which has been declared to be desirable, namely that a surety is discharged by any alteration in the original contract which varies his risk. Hence direct action against the principal debtor is precluded, and the result well may be that the debtor will lose all efforts to fulfill his obligations to the material disadvantage of the surety.

When the reservation rule is applied to releases, however, the surety is likely to be injured, for the creditor must bring any action that he may start directly against the surety Thus the affirmative burden to take action against the principal debtor is thrown enterely upon the surety. A reservation of rights in an agreement to release the principal debtor so substantially increases the surety's burden as to reach an equitable result and should be disregarded.

Thus viration in the surety's risk, affording one basis for discharging the surety when the principal debtor is released, is equally present whether the rights against the surety are or are not reserved. An agreement between the creditor and the principal debtor, to which the surety is not a party, should in no way be allowed to prejudice the surety's rights. The Courts should follow the lead of the ohio Supreme Court in refusing to give effect to the reservation clause in a discharge of the principal debtor.[64]

Mere Forbearance

Mere voluntary forbearance of the creditor or his mere passive indulgence in favour of the principal debtor, however, long continued, will not, in general, discharge a surety when such forbearance constitutes no violation of special contract terms, or involves no fraud, collusion or breach of good-faith. The reason usually given for this rule is that a surety is in default the moment his principal debtor is in default and may pay at any time and persue his remedies against the principal debtor. The surety is subrogated to the rights, remedies and securities of the creditor against him.

Section 137[65] clarifies in express terms what is clearly implied in section 135. What is required to cause the discharge of the surety is not mere forbearance on the part of the creditor to sue the principal debtor, but a positive Act, a promise or a contract, to give time, or not to sue. In view of section 137 the surety's liability towards the creditor remains unaffected even when the creditor has chosen not to sue the principal debtor.[66]

The scope of section 137 and 141 has been explained in Hukum Chand Insurance Co. Ltd. v. The Bank of Baroda.[67] It has been held that what emerges from a reading of sections 139 and 141 is that while a mere forbearance to enforce the security against the principal debtor will not discharge the surety, any act by which the creditor loses, or without the consent of the surety, parts with the security, has the effect of discharging the surety to the extentof the value of the security. Whether any particular act on the part of the creditor constitutes mere forbearance without more or constitutes an act by which the creditor puts it out of his power to hand over the security to the surety, will depend upon the facts and circumstances of the particular case.

Then another question arising for consideration is what is the difference between forbearance to sue and omission to sue? Forbearance to sue means refraining or abstaining from suing which may arise out of an agreement or because of the protection given under law, omission signifies breach of an obligation or duty either under law or agreement. Failing to do what ought to have been done results in omission. From a plain perusal of the meaning of the aforesaid terms it is clear that forbearance to sue normally does not result in penal consequences whereas omission to sue may result in penal consequences because there is breach of duty or legal obligation either under law or contract.

Supposing the surety reasonably apprehending that the principal debtor is trying to leave the local limits of jurisdiction of country informs the creditor by letter to proceed against him without fail and the creditor ignores the letter of the surety and keeps quit , this will be a positive omission in which case the surety will be absolved from his liability. The negative act, i.e., deliberate negligence (omission) is mentioned in E. Venkateran's Mercantile Law, where the author says, "that section 141 does not only apply to cases in which by positive action of the creditor, he has lost or parted with security without consent of the surety. This implies a negative act or negligence on the part of the creditor which would absolve the surety.

Mere forbearance to sue is not omission on the part of the creditor either by positive or negative acts. Section 137 has got to be read with section 128. According to section 128 the liability of the surety is co-extensive, meaning thereby that the creditor can straight way proceed against the principal debtor. Hence forbearance to sue hinges very much on the right of the creditor which gives him power to proceed against the surety. The vary purpose of the co-extensive liability of the guarantor will be stultified if section 137 is misinterpreted as omission. So let us not read section 137 in isolation which is very much coupled with section 128.[69]

Recently it has been observed in Bank of India v. Matha Goundra,[70] that the mere factum of forbearance to sue is not sufficient to constitute consideration for a person becoming a surety for the debt but there must be a promise, an undertaking to forbearer or an actual forbearance at the surety's express or implied request and such promise of the creditor must be capable of being enforced.

Imparing Surety's Remedy

It is a very well known rule governing a contract of guarantee that a person in whose favour a guarantee is given is bound to a faithful observance of the rights of the surety and to the performance of every duty necessary for the protection of those rights. Section 139 [71] incorporates in substance the rule that it is the duty of the person who has secured a guarantee to do every act necessary for the protection of the rights of the surety. It is the duty of the creditor not to do anything which is inconsistent with the surety's rights or omit to do any act which his duty to the surety requires him to do. If the violation of the aforesaid duties impairs the surety's eventual remedy against the principal debtor, the surety is discharged.

Section 139 is a residuary provision, its object being to ensure that no arrangement different from that contained in the suretyship contract is forced upon him and that if the surety pays the debt he has the benefit of every remedy which the creditor has against the principal debtor.[72] The basic principle of section is that it is the duty of the person who has secured a guarantee to do every act necessary for the protection of the rights of the surety, as a surety is a person who receives no benefit and no consideration out of the transaction but has voluntarily accepted the liability of the principal debtor to the creditor. By the application of this section surety is discharged, when a creditor does any act which is inconsistent with the rights of the surety or omits to do any act which his duty to the surety requires him to do and the eventual remedy of the surety is impaired as a consequences thereof. The impairment of the eventual remedy of the surety is essential for application of the section in addition to the acts of commission and omission on the part of the creditor. In order to attract section 139 there must not only be an act inconsistent with the rights of the surety or any omission to do any act which his duty to the surety requires him to do, but also the impairment of the eventual remedy of the surety against the principal debtor.[73]

In Darshan Ram Ganesh Das v. Khair Din Allah Buksh[74] a compromise decree was passed against the principal debtors providing for the payment of the debt by instalments. A person stood surety for the due payment of such instalments. Subsequently permission was granted to the judgment-debtors to mortgage and sell the property that was attached before judgment. Abdul

Raoof, J., said, " when the surety undertook the liability to pay the entire property belonging to the judgment-debtor was under attachment and the surety must have felt secure when he undertook the liability. The moment permission was granted to the judgment-debtors to effect private mortgages or sales the whole position was changed, and in my opinion, the surety was justified in applying to the court to be relieved of his undertaking".

A person standing as a surety, for several defendants in respect of a decree that may be passed against them, is discharged if the plaintiff with the leave of the court proceeds against one of them alone exonerating the rest of the defendants. In a recent case decided by the Supreme Court as surety was held discharged due to the action of the Government.[75] The facts of the case were that the Government allowed the purchaser even after the default in the payment of the price was made to remove the fallen trees which the purchaser according to the terms of the contract was authorised to remove only on full and final payment. In allowing the purchaser to remove the fallen trees the Government had omitted to do what the surety, was required to do and so, the surety's exentual remedy against the security was lost.

The commission or omission on the part of the creditor must prove injurious to the surety. There must be the impairment of surety's ~~a~~remedy. As in Ramanand v. Chowdhry Soondar Narain,[76] the decree-holder postponed the sale of properties under a decree which resulted in increased burden of the interest on the sureties who had executed a bond undertaking to pay any deficiency after sale. It was held that the sureties were discharged from liability for interest subsequent to the court's order for sale.

Mere laches on the part of the creditor or a mere passive acquiescence by the creditor in acts which are contrary to the conditions of a bond, is not sufficient of itself to relieve the sureties. Mere non-exercise of their rights of super-intendence by the people having that right does not discharge persons standing surety for those who are under supervision from their liability as sureties.

To sum up, if there is a contract, express or implied, that the creditor shall acquire or preserve any right against the principal debtor, and the creditor deprives himself of that right which he has stipulated to acquire, or does anything to release any right which he has, that discharges the surety unless he can show that he has received some injury in consequences of creditor's conduct.

In order to attract this section there must not be either an act inconsistent with the rights of the surety, or an omission to do an act which it is the creditor's duty to do, but also the impairment of the eventual remedies of the surety against the principal debtor. The last point is most crucial, so that if there is no such impairment the surety is not discharged. Lord Longdall observed in <u>Calvert</u> v. <u>London Dock Coy</u>[77]

> "In almost every case where the surety has been released either in consequence of time being given to the principal debtor or of a compromise being with him, it had been contended that what was done was benefient to the surety, and the answer has always been that the surety himself was the proper judge of that, and that no arrangement different from that contained in his contract is to be forced upon him, and bearing in mind that the surety, if he pays the debt, ought to have the benefit of all the securities possessed by the creditor, the question always is whether what has been done lessons the security".

Losing or Parting with the Security

Section 140[78] enshrines the general common law principle relating to cases where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place. A surety, who pays off the guaranteed debt or performs the promise is entitled to be subrogated to all the rights of the creditor which he had against the principal debtor. Section 141[79] contains the most practical application of the principle laid down in section 140. Because under the section a surety is entitled to the benefit of "every security" which the creditor has against the principal debtor at the time when the contract of suretyship is entered into whether the surety knows the existence of such security or not, the section also provides that if the creditor loses, or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of security. It has been observed in Craythorns v. Swinburm,[80]

> " The whole doctrine of principal and contribution,etc. rests upon the established principles of a court of equity, not upon contract,except it may be so represented upon the implied knowledge of these principles. There is no express contract for contribution of bonds generally, if not universally being joint and

> several-creating several obligations by in as surety is to be entitled to every remedy which the creditor has against the principal debtor; to enforce every security and all means of payment to stand in the place of creditor, not only through the medium of contract, but even by means of securities entered into without the knowledge of the surety, having a right to have for that, and to avail himself of all those securities against the debtor. This right of a surety also stands, not upon contract, but upon a principle of natural justice".

On the scope of section 141 Ramaswami, J., of the Supreme Court in Amrit Lal v. State Bank of Travancore,[81] said, that as pointed out by the Court in State of Madhya Pradesh v. Kalusan,[82] the expression security' in this section is not used in any technical sense, it includes all rights which the creditor has against the property at the date of contract. The surety is entitled on the payment of the debt or performance of all that he is liable for the benefit of the rights of the creditor against the principal debtor which arise out of the transaction which gives rise to the right or liability. The surety is, therefore, on payment of the amount due by the principal debtor entitled to be put in the same position in which the creditor stood in relation to the principal debtor. If the creditor has lost or parted with the security without the consent of the surety the latter is by the express provision contained in section 141 discharged to the extent of the value of the security lost or parted with.

Section 141 deals with a situation when the principal debtor has offered more than one security. Even if the surety is not aware of any other security offered by the principal debtor yet once the right of the surety against the principal debtor is impaired by any action or in action which implies negligence appearing from lack of supervision undertaken in the contract, the surety will be discharged under the combined operation of sections 139 and 141.[83]

Section 141 embodies the equitable principle in favour of the surety. This is one of the instances of some favour shown to the surety. Section 137, however, make quite clear that by'mere forbearance' the surety is not discharged. The difficult question is whether there is a mere forbearance' by the creditor or whether he has lost or parted with the securities to the prejudice of the security. The Supreme Court decided in favour of the sureties under section 141.[84]

On the contrary in Karnataka Bank Ltd. v. Gajana Sharkara Rao Kalkarni,[85] the Karnataka High Court has come to the conclusion that the surety was not discharged under section 141. The bank had financed the instalmental purchase of a truck by way of security, besides providing two sureties for the repayment of the loan. Under the hypothecation bond, the creditor was entitled to seize the truck and sell it, if the principal debtor committed default in the payment of any one kinstalment. Though all the instalments have become overdue, the creditor bank did not seize the truck. In the mean-while, the truck deteriorated in value and was reduced to a mere scrap. The creditor sued the principal debtor and sureties for the amount due. The sureties invoked the protection of section 141 and contended as the creditor bank had allowed the security to be impaired and lost owing to its own negligence, they stand discharged. The trial court found favour with their claim but the Division Bench on appeal, held that section 141 would not apply to the case. Venkatachaliah J., stated the reasons thus:[86]

> " A mere passive inactivity or passive negligence on the part of the creditor by failing to realise the debt from the collateral security is not sufficient in itself to discharge the

> surety, for the reason the surety can himself avoid consequences of such passivity by himself paying the debt and becoming subrogated to the rights of the creditor. In the absence of a contract to the contrary, the creditor is under no obligation of active diligence for the protection of the surety, so long as the surety himself remains inactive. Thus tested, the inaction on the part of the bank will not of itself, mitigate sureties liability".

The court distinguished the Supreme Court decisions on the ground that unlike the present case, the creditors there had physical custody of the security and that they were not cases of ' mere forbearance' but of security lost owing to the negligence of the creditors. There was a unsuccessful contention that a hypothecation of goods was only an extended idea of the pledge and that the obligation to preserve the security enjoined by law upon a creditor extended not merely to the security which was in his actual possession but also that which he ought to have taken into his actual possession by exercising the right to seize the goods upon default. The decision which, it is submitted with respect, is eminently sound and is bound to be welcomed by bankers and other instalment credit financeries.[87]

The same High Court reached the same conclusion in R. Lilavati v. Bank of Baroda.[88] The Punjab and Haryana High Court in a recent decision while over-ruling its earlier decision[89] has in Bank of India, Bom. v. Yogeshwar Kantwadhera,[90] held that a surety in the case of hypothecation is not entitled to invoke section 141 of the Contract Act for his benefit. Under the said section if the creditor loses or without the consent of the surety, parts with the security pledged, the surety is discharged to the extent of the value of the security. Such a question cannot arise in the case of hypothecation, of goods for the simple reason that when the goods are not in possession of the hypothecatee, there is no question of his losing or parting with the same. Therefore, the sureties could not claim the benefit of section 141 of the Act.

Section 141 of the Indian Contract Act has limited the surety's right to securities held by the creditor at the date of his becoming surety and has modified the English rule that the surety is entitled to the securities given to the creditor both before and after the contract of surety.

According to section 141 a surety is entitled to the benefit of every security which the creditor had against the principal debtor and section 140 lays down that the rights should have been available to the surety upon payment or performance of all that he is liable for. But the Act no where lays down at what point of time the creditor's securities should be made over to the surety. Whether when the debt is paid off, or when the surety pays the sum guaranteed. In Goverdhandas v. Bank of Bengal,[91] it was held that the surety was not entitled to the creditor's securities until the whole of the debt was paid off. Farran, J., said:

> " It seems to me to be a strange doctrine that a creditor not fully secured by a mortgage who obtains the benefit of a surety for part of his mortgage debt in order to further secure himself by that very act is deprived of portion of the security the inadequacy of which was a reason for demanding the surety; or that a person advancing say Rs. 10,000 on a mortgage which is valued only at Rs. 5,000 and has Rs. 5,000 of his advance guaranteed by a surety is only in reality secured to the extent of Rs. 7,500 by reason of the surety's right to claim the benefit of half the mortgage security on paying his half of the debt. To hold so would, I think, defeat the intention of the parties to such a transaction. A principle of equity is seldom adopted which had that effect. If such were the result of

> section 141 of the Contract Act, I should expect to find the wording in section 140 repeated in section 141. The striking difference in the language of the two sections is a strong argument against the plaintiff's contention".

In <u>Porvateneni Bhushayya</u> v. <u>Pootluri Suryanasayana</u>,[92] a different view has been taken while in the case only section 141 was invoked, in the Madras case both sections 140 and 141 were relied upon. But in the Madras case the security was given subsequent to the contract of guarantee. In this case the surety had guaranteed only part of the debt. This guarantee he discharged and so the court held that as against the subsequent assignee of the creditor he was entitled to a proportionate share in the security held by the creditor at the time the surety discharged his liability. This was so even if the creditor wasmnot fully paid. The Madras High Court held:

> " There is little doubt on the language of section 140 that the surety is entitled to demand all the securities held by the principal debtor at the time of the payment , whether they had been received simultaneously with the loan advanced or subsequently What is important to remember in this connection is that section 141 does not enable the creditor to withhold from the surety any security actually held by him at the time when the debt is paid or in any way to detract from the rights of the creditor as declared by section 140. Section 141 only gives

> him liberty in action in respect of securities not held by him at the time of the contract of suretyship provided he exercises it before payment".93

Pollock and Mulla,[94] agreed with the opinion expressed by Faran J., when they state :

> " The Madras Court doubts the view of Faran J, but no attempt is made to deal with his argument on the equities. Further, the solution in the Madras case, it is submitted, is inequitable. The Court considers that any other view would enable a creditor to make an appropriation to the detriment of the surety who has already paid. But it is submitted that if the creditor has negligently sold the security to H at least than its market value the surety is protanto released.95 If on the other hand H has paid the full market value, it is inequitable that he should be called upon to share it with B. Further, the very basis of the surety's right to securities rests upon the obligation of the principal debtor to indemnify the surety. It would be strange if the surety could use these rights to hamper the creditor in recovering the debt.96 It is submitted that the creditor's right to hold securities until the whole debt has been paid is paramount to any claim of the surety whether based on section 140 or section 141. "

The above view is in confirmity with the provisions of law and no surety can step into the shoes of the creditor until he has discharged his liability and until the entire debt due to the creditor has been paid in full. This rule shall apply also where the surety is only for the part of the debt.

The Law Commission[97] has also taken the same view

Another question worth examining relates to the case where more than one security is available to the creditor. In case the creditor takes more than one security on the basis of which the advance was made, it shall not mean that section 141 would not be attracted and the surety will not be discharged. Even if it is found that surety gave personal guarantee on the good-faith of the other security being offered by the principal debtor, which itself may be a consideration for the surety offering his personal guarantee, and the creditor by his own negligence lost the securities. In case such an interpretation is provided, it would mean that law is rewarding negligence and that law is putting a premium on the negligence of the creditor to the detriment of the surety who is usually described as a favoured debtor.

In any case the bank should exercise the care of a prudent man one would expect in management of its own affairs.

The next question for consideration is that whether under section 141 of the Contract Act, a surety undertaking to pay the amount due to the creditor under a particular debt or account is entitled to the benefit of the security held by the creditor against the same debtor to secure the same amount under other debt due to him. This matter came up for decision in the Rajasthan High Court in Bank of Baroda v. Krishna Ballabh and others,[98] the court held:

> "Keeping in view the language of section and illustration appended to it, it is clear that the principle in-corporated in section 141 applies, so as to discharge the security from the liability, only in a case where the creditor loses or parts with the security held by himkto secure the same debt for which the contract of suretyship was entered into. If there are two or more debts each secured by security the surety for one of the debts is not discharged if the creditor loses or parts with the security relating to other debts. In view of the above, I do not agree with the learned Additional District Judge that the plaintiff's liability as surety was discharged on account of the release of the goods pledged

with the Bank to secure the
amount under cash credit
Account of M/s Jem Chemical
and Pharmaceutical Works".

In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. In fact the contract of suretyship has the foundation of indemnity. The surety can claim from the principal debtor whatever sum he has rightfully paid under the guarantee. He however, cannot claim any amount which may have been paid by him wrongfully. In case surety pay less than what is due from the principal debtor he is entitled to receive the sum actually paid by him.

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13. (1878) 3 Q.B.D. 495
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18. Section 237 is as:

    When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligations were

within the scope of the agent's authority.
illustrations

(a) A consigns goods for B for sale and gives him instructions not to sell under a fixed price. C being ignorant of B's instructions, enters into a contract with E to buy the goods at a price lower than the received price. A is bound by the contract.

(b) A entrusts B with negotiable instruments endorsed in Blank. B sells then to C in violation of private orders from A. The sale is good.

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CHAPTER - VI

LETTERS OF CREDIT AND PERFORMANCE GUARANTEES

Banking, if we equate it with money lending, is perhaps as old as civilization itself. When "money" in its modern form was not in existence, people in order to obtain goods or services, offered goods or services in return. This was barter, a clumsy and inconvenient system in many ways. Nevertheless people could and did lend or borrow in the form of specific goods which they received back or repaid in the same form or any other mutually acceptable form. Banking institutions today form the heart of the financial structure of any country, developed or developing, rich or poor, advance or backward in the fields of science and technology. Developing economics are in greater need of the creative and purposeful role of the banks than the developed ones.

Banks borrow in order to lend. Every lender of money must have a lively regard to the chances of obtaining repayment, and from the earliest times he has seldom been content with relying upon the mere obligation of the borrower to fulfil his obligation unless buttressed by a proper security. The business of lending money is very speculative, and can only be carried on by charging interest so ghigh that it could hardly serve the ordinary requirements of commerce and industry.

At the present time perhaps the most important ancillary service rendered by a banker to his commercial customer is the providing of credit which will enable the customer to discharge his obligations. The main feature of this, however, is that the banker through his business connections is able to place the machinery of international commercial banking at his customer's disposal.

In the absence of a continuous course of dealing, sellers are concerned with the availability of prompt payment for their merchandise. Buyers, on the other-hand, are naturally anxious to have an opportunity of inspecting the goods before payment of price in order to ensure that the goods conform to the agreed quality. The whole question is, of course, resolved when there is mutual trust and respect among the parties developed by continuous and repeated advantageous dealings between them.

In the absence of such dealings, however, it becomes necessary for a system to be developed where by a seller can sell his goods to a buyer to their mutual satisfaction in those situations where neither party knows the other. This basic need has brought the development of the letter of credit.

International trade needs some mechanism whereby payments may be made across national boundaries, and currency of one country be valued in terms of the other. Commercial credits are used to facilitate commercial relations, say, between an imperter or exporter in one country, and a merchant abroad, or in financing the shipment of merchandise from one country to another. The importer gets his banker to issue a documentary credit which incorporates an undertaking to accept or pay bills of exchange upto a certain amount by the merchant abroad provided that they are accompanied by specified documents.

When bank participation is desired, the usual vehicle for such participation is the use of a letter of credit which has the added advantages of permitting each party to the transaction to deal with a financial institution in which he has confidence and which is known to him.

Purpose and functions

Commercial letters of credit are in constant use, they involve large accounts, their nature and effect are well understood in the business world. When a prospective buyer in some locality desires to purchase goods of a prospective seller in another locality there arises the problem of financing the sale. If the seller is to manufacture the goods, or to procure the merchandise from some third person, he wishes to be certain that the buyer will take and pay for them when they came into existence, or are procured, and put on board the ship or cars. If the seller already had the goods, he desires to be paid the purchase price upon shipment. The buyer, on the other hand, wishes to be certain that the goods have been shipped according to the instructions and he does not desire to pay before they have been received and marketed.

Payment may be made, according to the terms of the sales contract, in one of five ways: (1) Cash with the order or against shipping documents; (2) the buyer's promissory note or the note of a third person, or bill of exchange on a person other than the buyer, properly accepted and indorsed, sent with the order, or servant against the shipping documents; (3) open or book, credit with subsequent remittance cash or commercial paper; (4) trade acceptance or bill of exchange drawn by the seller on the buyer; (5) letter of credit. None of the first four methods is satisfactory - both to the buyer and to the seller. The business problem is how to meet the desires of both the buyer and the seller, how to enable the buyer to postpone actual payment until the goods have been received and resold, how to enable a bank to lend its credit and not its funds, how to utilize the goods as security in the meantime. The instrumentality of the commercial letter of credit meets these requirements perfectly.[1]

Under a commercial letter of credit S, a seller in Pakistan, wants to sell to B, a buyer in India, B goes to his bank, the State Bank of India, and requests them to send a letter of credit to S in Pakistan. Such letter acknowledges that upon presentment of the proper documents of the title (e.g. bill of lading, invoices, customs documents etc.) from S to the bank, the bank will pay any drafts drawn on B upto a certain amount. The bank honours its letter of credit, pays the draft and remits the payment to S for a small charge. The bank now turns to B for payment. This can be done either by debiting B's account for the amount of draft, by taking a security interest in the goods in transit,or by holding the documents of title until B can find another buyer who will pay the bank.

The commercial letter of credit is used as a means of financing and paying for international sales of the documentary variety. Its purpose was to unable an exporter to draw his draft or bill of exchange upon a bank or factor of known solvency, instead of upon the importer. The banking or factoring house to accept or pay the sellers draft or demand for payment, according its promise with a specification of the documents required to be presented by the seller or seller's agent or bank. The commercial letter of credit may be defined as a formal promise by a bank or other party of known solvency to accept or pay or just to pay, the draft or the demand of payment by a beneficiary, whose compliance with the terms of the credit is a prerequisite of the enforceability of the promise.

The main alternative methods of payment that were available to an exporter at the time the commercial letters of credit began to be used were the following:[2]

He could be paid before or after shipment by receiving a remittance of exchange directly from his buyer or through a bank. If the exporter were paid prior to shipment it meant that the sale was on a strictly cash basis, the buyer, was to trust implicitly the sellers honesty in shipping the bargained goods. If payment were to take place after shipment or reception of the goods by the buyer, the seller would normally face the credit risk of an insolvant or dishonest buyer refusing to honour his obligation in a foreign country, and the additional risk of an interim devaluation of the currency of the payment.

A second method of payment was the drawing of a documentary draft on the buyer. The seller's draft would normally be accompanied by the customary C.I.F., F.O.B., F.A.S. etc. documents which would only be released to the buyer by a third party, usually a bank, upon the buyer's paying or accepting the sellers draft. One important practical implication of the documentary draft method of payment was that it favoured the interests of the foreign buyer. Not only did the buyer enjoy the disposition of cash until the moment of payment of the accepted draft, but in addition, and perhaps more importantly, the buyer could exact more liberal terms from his seller by refusing to accept the documentary draft or instructing his bank not to pay a sight draft. The seller was then forced with the prospect of litigating in a foreign country without material possession of the goods, which were either traveling across the ocean or awaiting final adjudication in a foreign customs house.

In contrast with these two methods, the advantages effered by the commercial letter of credit are obvious. The seller can count on an enforceable promise of payment by a party of known selvency as soon as he receives a formal document (issued by a bank a board or by a confirming bank at his domicile) stating that his draft will be honoured when accompanied by the specified documents. This virtually ends the seller's credit risk and allows him to cope better with the exchange risk.

The buyer is assured that the payment under the commercial letter of credit will take place only when the seller complies with the terms of the credit as specified in the buyer's instructions to the opening or issuing bank. In addition, the buyer also has access to bank credit because he can provide security for his borrowings from the issuing bank by transferring to the bank possession of the documents of title over the merchandise shipped under the commercial letter of credit.

Finally, importers dealing through banks are protected against a drop in the value of their national currency by the issuing banker's mechanism for the adjustment of its exchange position. For a bank with international connections, the setting aside or the transfer of exchange is a routine and relatively inexpensive transaction.

Its foreign currency obligations to correspondents abroad as well as its local currency credits on foreign banks are periodically settled through respective book enteries. Because of these as well as other factors the commercial letters of credits has become the most significant instrument in the financing and payment of international sales.

The function of a documentary credit can best be described and the parties identified by giving a simple example suppose that a buyer in London wishes buy a consignment of raw jute from a seller in India at a cost of £ 45,000. The contract for the saled jute, which is on C.I.F. (cost, insurance and freight) terms, provides that the payment shall be by confirmed irrevocable letter of credit against delivery of the shipping documents concerning the jute, i.e. bill of lading, invoice and policy or certificate of insurance. The contract further provides that the letter of credit must be opened by the buyer at least one month before the intended shipment date. The bank will require the buyer to complete and sign a request form. The request form sets out details of the required letter of credit. Specifies that the letter of credit is to be subject to the uniform customs and practice and specifically gives the bank a charge over the shipping documents and the goods represented thereby together with, if necessary a power of sale. The bank may also require other security since, by opening the credit, the bank will be making the credit, the bank will be making itself primarily liable to make payment under it.

The bank which is called the issuing bank, then opens the letter of credit and sends it to its correspondent bank in india by letter, or in urgent cases communicates the terms of the letter of credit by telex or cable, in either case asking the bank in India to add its confirmation to the letter of credit and notify the seller (i.e. the beneficiary under the letter of credit). By adding its confirmation the confirming bank itself accepts liability to make payment under the letter of credit in that way, the seller has a bank resident in his own country to look for the payment.

When the goods are shipped, the beneficiary draws a draft as instructed in the letter of credits i.e. on the confirming bank or on the issuing bank or on the buyer and hands this draft to the confirming bank, or to his own bank in India (i.e. a negotiating bank), together with the letter of credit and the shipping documents specified therein. If he presents these to the confirming bank, that bank honours the draft if drawn on itself or negotiates (i.e. buys) the draft if drawn on or other party, always provided that the accompaning documents are in order. If he presents then to his own bank, that bank negotiates, the drafts in reliance on the undertaking of the confirming bank supported by that of the issuing bank. In this way, the seller is paid immediately but the buyer does not have to pay for the goods until the draft and the shipping documents are presented to the issuing bank for payment.

The object from a business point of view of the commercial credit is to facilitate dealings between merchants domiciled in different countries, by ensuring payment to the seller on the one hand and delivery to the buyer of the contract goods on the other. It is in international commerce that the banker's commercial credit plays a leading part. A transaction of this nature presupposes the case of a merchant whose credit in his own country may be all that could be desired, but who is not sufficiently well known in other markets to enable him to rely solely on his reputation for solvency and honest dealings when buying goods abroad. It may be essential that he should be able to purchase on credit, if he cannot afford to be deprived of the use of his capital during the period which must of necessity elapse between the shipment of goods and their receipt and resale by him in the home market. Similarly, the exporter also may be in need of credit, for he may not be able to afford to lock up capital which is required in his own business pending the receipt of payment for his goods. Thus some expedient is necessary which will, on the one hand, enable the exporter to obtain prompt payment, whilst allowing the imperter to postpone payment until such time as he has been able to market the imported goods.

Letter of credit is no novel device. Foreign trade has been financed in this way, or in some similar manner, commerce has at times been carried on in new channels, and not always with persons of unblemished repute, and moreover, exporters of goods have been much embarressed by violent fluctuations in rates of exchange and by devaluation of currencies. For these reasons there has been a marked disinclination on the part of exporters to rely on the individual credit of buyers and an increasing tendency for the exporters to stipulate in contracts for the sale of goods that the responsibility for payment of the price shall be undertaken by a banker, it is submitted that even if importers and exporters are of good repute it may be preferable to finance a transaction by means of a documentary credit, for in times which are uncertain by reason of hostilities or the chance of hostilities, payment may be more easily forthcoming, as bankers maintain accounts with each other which cannot so easily be subject to foreign governmental control or interference.

Nature of letter of credit

The commercial letter of credit has a long mercantile history. It has,however, a much shorter legal history. It is not a new thing in English and American Law. Although merchants and bankers have been using letter of credit for decades, and for long experience, more or less uniform, understood in a business way the business obligations which are created as a result of their issue. It is nevertheless uncertain in what manner or at what moment of time the law predicates upon their legal rights and obligations.[3] Do rights and obligations arise at the moment the letter is issued as the result of a contract which is founded at that time or to obligations and rights arise at a subsequent time.[4]

Just as the bill of exchange had its origion in the necessity of settling accounts between merchants residing in different countries without the necessity of transporting money itself, so the letter of credit was first used to fulfil the purpose of providing a person abroad with money itself and thus obviating the necessity of his carrying money with him. In their earliest letters of credit were used as long as the twelfth century by Popes, princes and other rulers who wished to purchase advances for their servants. They were sometimes used in the name of king, or for the benefit of his subject, who were thus enabled to raise loans upon a known security.[5]

The modern commercial letter of credit is of recent growth. It is given not to the customer, but to some third person named by the costomer, with whom the customer has commercial dealings in order to carry through a particular transaction. In effect, the name and reputation of the banker are substituted for those of his customer.

This disturbed economic condition of the world following two world wars, the great increase in world trade, the more rapid means of communications and transport, the embarking upon commercial adventures by men of doubtful honesty, the fluctuations of foreign exchange and all factors which it is believed have had a profound influence in shaping the form of letters of credit.

A letter of credit is in principle an undertaking by a banker to meet drafts drawn under the credit by the beneficiary of the credit in accordance with the conditions laid down therein. A letter of credit where the credit is designed to facilitate trade (generally, but not always foreign trade) to another specified banker (called the intermediary banker) or to the beneficiary.

The credit is addressed to the intermediary banker, it may contain an instruction to that banker, either merely to advice the beneficiary of the credit without any commitment, or to add his confirmatary undertaking to it, in which case the beneficiary has the promise of both bankers except when the confirming bank issues his own credit to the beneficiary when a credit is intended to facilitate trade it is called a commercial letter of credit.[6]

According to another definition of documentary credit the banker acting on behalf of the buyer and either directly or through the intervention of a banker in the country of the seller, assumes liability for payment of the price in consideration, perhaps of the security afforded to him by a pledge of the documents of title to the goods or his being placed in funds in advance or of an undertaking to reimburse and of a commission.[7]

This description reveals the essence of the transaction, viz. that the goods represented by the bill of lading or a document of title are used as a means of financing the transaction. Lord Wright describes the function of documentary credit as follows:

> The general course of international commerce involves the practice of raising money on the documents so as to bridge the period between the shipment and the time of obtaining payment against documents. 8

A comprehensive definition of the documentary credit is to be found in the uniform customs and practice for documentary credits, 1974,[9] sponsored by the international chamber of commerce, where it is provided that a commercial credit is:

Any arrangement, however, named or described whereby a bank (the issuing bank) acting at the request and in accordance with the instructions of a customer (the application for the credit),

(i) is to make payment to or to the order of a third party (beneficiary) or to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or (ii) authorise such payments to be made or such drafts to be paid, accepted or negotiated by another bank, against stipulated documents, provided that the terms and conditions of the credit are complied with.

The fundamental principle of the uniform customs is to provide for a strict separation of the documentary aspect of the export transaction from the goods aspect and to make it clear that the banks are only concerned with the former but not with the latter. The uniform customs further demand that credit instructions and the credits themselves shall be complete and precise and that the issueing bank shall discourage any attempt on the part of the buyer to include exercise detail.

Many provisions of the 1974, which have stood the test of time, have been retained. The general temar of 1983 Revision is to relent to some extent, the doctrine of strict compliance, by stating that more transport documents shall be acceptable by the banks, if the parties have specified this in the instructions to the issuing bank. This change is due to transport revolution which in many cases had led to the use of other transport documents than the traditional bill of lading.[10]

The 1983 version of U.C.P. set-out to achieve three aims. It adopts the U.C.P. to the changing documentary requirements of the transport revolution, it makes it possible to use in documentary credit transactions modern means of tele communications and automated transmission,[11] and thirdly it is more precise in its wording than the previous version of the U.C.P.

There are three stages in the transaction First, a term is inserted in the contract of sale made between the buyer and the seller whereby the buyer undertakes to furnish an irrevocable letter of credit in favour of the seller. Secondly, the buyer approaches his own banker and instructs him to issue an irrevocable letter of credit, giving him the details of the transaction. This constitutes a contract between the buyer and the banker. Thirdly, the banker advices the seller that an irrevocable letter of credit has been opened in his favour, that is to say, the banker gives an irrevocable undertaking to pay the seller, provided that the seller sends the required shipping documents in compliance with the terms of the letter of credit. An irrevocable letter of credit may also be confirmed by a banker operating in the seller's country (known as the correspondent banker) who by confirming the credit, adds to the promise of the issuing banker his own undertaking to ensure payment. The irrevocable letter of credit does not fit easily into the common law. If the transaction is regarded simply a contract between the buyer and the banker, the seller is a third party to this contract and technically would be unable to sue should the banker revoke the letter of credit or for some reasons fail, to make the payment. But the letter of credit is treated as a unilateral contract between the banker and the seller to pay on the tender of the shipping documents.[12] In Trans Trust S.R.R.L.v. Danubian Trading Co. Ltd.,[13] the question was what is the legal position of a stipulation in a contract of sale of goods which related to the opening by the buyer a letter of credit in favour of the seller? Sometimes it is a contract precedent to the formation of a contract, that is, it is a contract which must be fulfilled before any contract is concluded at all. In those cases the stipulation subsequent to the opening of credit is rather like a stipulation subject to the contract.

As to the nature of the transaction, we can say that it is independent of and unqualified by the contract of sale or underlying transaction. It has an autonomy of its own, that the opening of a confirmed letter of credit, constitutes a bargain between the banker and the vender of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute that may be between the parties as to whether the goods are upto contract or not. A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. On this aspect, lord Dinning M.R., in the case of Edwardowen Engineering Ltd. v. Barclays Bank international Ltd.,[14] point out:

> " A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer, nor with this question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee ."

In this case the British suppliers agreed to erect green houses in Libya and established a performance guarantee of 10 percent of the contract price issued by the English bank payable at the Libyan bank. The letter of credit was never opened. The English suppliers considered this as a repuditation of the contract. The Libyan importers claimed on the bank guarantee. It was held that the Libyan importers indeed had the right to call upon the guarantee, irrespective of the dispute concerning the underlying contract. The on demand guarantee was payable on first demand without proof or conditions. In Edwardowen case Lord Denning M.R. remarked[15] - " these performance guarantees are virtually promissary notes payable on demand".

One fundamental principle which operates in letter of credit transactions is that a letter of credit is a separate transaction from the contract of sale and the bankers who issue a letter of credit are in no way concerned with the contract of sale. The basic principle is embodied in Article 3[16] and Article 4.[17]

Although the underlying basis of a letter of credit are clearly stated in the above articles, buyers of the goods have often sought to interfere with the bank's payment obligations. This would occur, for instance, in cases where the seller is in breach of his contract by supplying goods which are defective or not upto standard. Another situation where the buyer might seek to interfere with the bank's payment obligations is where the buyer suspects that the seller is acting fraudulently in the transaction.

Once a credit has been communicated by the issuing bank to the beneficiary, it constitutes a definite undertaking by the issuing bank to the beneficiary that it will pay on the credit if the terms of the credit are met. If the seller is in breach of his contract to the buyer by supplying goods which defective are not upto the stand, the buyer may attempt to stop the seller from drawing on the credit in order to preserve his own claim for damages against the seller. The courts have always refused to interfere with the banker's undertaking to make payment under the credit on the ground that any such interference would undermine the confidence in this system of payment. They have consistently held that banks are in no way concerned with the contract of sale and the buyer should seek his remedy against the seller in a separate action. In <u>Hanzeh Malas & Sons</u> v.

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British imex Industries Ltd. the court of Appeal decided that the buyer must seek his remedy for breach of contract in separate action against the seller. The plaintiffs, in this case, a Jordanian firm, agreed to purchase from the defendants, a quantity of reinforced steel rods. The goods were to be delivered in two kinstalmehts and the payment was to be effected by two confined letters of credit, After the first delivery, the plaintiffs alleged that the goods were not upto the contract. The plaintiffs applied to the court for an injunction to prevent the defendants from drawing on the second letter of credit. The plaintiffs contended that this move was intended to secure for themselves in respect of any damages they might become entitled in a subsequent action against the sellers. This application was disallowed by the court of appeal on the ground that a vendor selling under the assurance that nothing would prevent him from receiving the prices. Jenkins L.J. said: 19

> " we have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargaining between the banker and the vendor of the goods, which imposes upon the banker's

> an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are upto the mark or not. An aleborate commercial system has been built up on the footing that the banker's confined credits are of that character, and,in any judgment, it would be wrong for this court in the present case to interfere with that established practice. A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price- That system of financing these operations, as I see it, would break down completely if a dispute as between the vendor and the purchaser was to have the effect of 'freezing', if I am use that expression, the sum in respect of which the letter of credit was opened".

The above principle was recently applied in the case of Forestal Mimosa Ltd. v. Oriental Credit Ltd.,[20] the plaintiffs in this case sold to buyers in Karachi five consignments of solid wattle mimosa extract. The goods were to be paid for by means of irrevocable letter of credit and the credits were to be subject to the U.C.P. (1983 revision). The plaintiffs tendered the required documents to the defendants, the confirming bank. The defendants in turn transmitted the documents to the issuing bank which claimed that the documents contained a number of discrepancies and that funds would be remitted upon their receipt from the buyers.

subsequently the issuing bank informed the defendants that the buyers had accepted the drafts with the following endorsement, " Accepted on clean collecting basis not under L/C". The plaintiffs refused to accept this amendment. They then sued the confirming bank for failing to accept and pay the drafts. The confirming bank contended that their obligation under the letter of credit only arose upon the buyers accepting the drafts. Rejecting this argument, the court of Appeal held that the bank was under an obligation to accept and pay for the drafts once proper documents have been tendered. Sir John Mcgow said[21]:

> " The purpose or, at any rate, one of the important purposes- of such a credit, as it is understood in international finance, is that it shall not be open to the buyers by his own choice with, it may be, no kind of legal justification whatever, when proper documents are tendered, to render the bank's obligation to the seller under the credit wholly useless obligation and one that has no legal effect".

In United City Merchants (investments) Ltd. v. Royal Bank of Canada and others[22], Lord Wilber force described the four autonomous though inter connected contractual relationships" involved in the documentary credit.

(1) The underlying contract for the sale of goods, to which the only parties are the buyer and the seller;
(2) the contract between the buyer and the issuing banker under which the latter agrees to issue the credit and either itself or through a confirming bank to notify the credit to the seller, and to make payments to or to the order to the seller against presentation of stipulated documents; and the buyer agrees to reimburse the issuing bank for payments made under the credit. For such reimbursement the stipulated documents; if they include a document of title such as bill of lading, constitute a security available to the issuing bank;
(3) if payment is to be made through a confirming bank, the contract between the issuing bank and the confirming bank authorising and requiring the latter to make such payments and to remit the stipulated documents to the issuing bank when they are received, the issuing bank in turn agreeing to reimburse the confirming bank against the payments made under the credits;
(4) the contract between the confirming bank and the seller under which the confirming bank undertakes to pay to the seller up to the amount of the credit against presentation of stipulated documents.

It is clear from the above discussion that a letter of credit gives rise to a separate contract between the bank and the seller, separate and distinct from the contract for the sale of goods between the seller and the buyer. The autonomy of a letter of credit is entitled to protection.

In documentary credit operations all parties concerned deal in documents and not in goods.

A letter of credit is a mechanism of great importance in international trade and any interference by courts with that mechanism would have serious repercussion on internation trade, except under very special circumstances.[23]

Once the seller complied with the requirements of the letter of credit the court will not be justified in granting injunction restraining the bank from paying the seller.

There is an absolute obligation upon the bank to pay irrespective of the dispute between the buyer and the seller as to whether the goods supplied by the seller were in accordance with the contract.

Kinds of letter of credit

It is well settled that letters of credit could be both revocable and irrevocable.[24] Irrevocable letters of credit might be confirmed or unconfirmed. The contractual relationship between the issuing bank and the buyer is defined by the terms of agreement between the under which the letter opening the credit is issued, and or between the seller and the banker, the issue of credit duly notified to the seller creats a new contractual nexus and renders the banker directly liable to the seller to pay the purchase price or accept the bill of exchange upon tender of the documents. In Sassoon (M.A.) and Sons Ltd. v. International Banking Corporation,[25] Lord Summer said, " that there is no distinction from a legal point of view between an irrevocable credit and a confirmed credit, and that both were concluded contracts, but he was presumably referring to the legal effect of each, which as regards the beneficiary, is the same. An irrevocable credit is confirmed if it is added to the confirmation of another banker, by which that banker also binds himself irrevocably.

It depends on the nature of the credit whether it be revocable or irrevocable. In order that bank may claim to be reimbursed for any payment he makes under the credit, the paying banker must obey strictly the instructions he receives, for by acting on them he accepts them and thus enters into contractual relations with the opening or issuing banker.

There is also a difference between standby letters of credit and traditional letters of credit. Although both are mechanisms for allocating risks among the parties in commercial transactions. By placing in the hands of a neutral third party the responsibility for-making the payment when certain conditions are met, one party to a transaction is able to avoid the risk of non-payment or non performance. The standby letter of credit differs from the traditional letter of credit, however, in the method by which it allocated the risks among the parties. The traditional letter of credit usually requires a third party to generate some of the documents that the beneficiary must present to the issuer (usually a bill of lading), under the standby letter of credit, the beneficiary usually generates all of the necessary documents himself casually a simple statement that the customer is in default.

The standby letter of credit thus involves a greater, risk of improper demand than the traditional letter of credit, both for the customer and the issuing bank. Because the bank is prohibited from inquiring into the truth of the beneficiary's assertion, the customer faces a risk that it will have to reimburse the bank for making a payment that was unjustifiably demanded. The bank's risk of loss is also increased because, unlike a bank issuing a traditional letter of credit, it receives no bill of lading. In a traditional letter of credit transaction involving the sale of goods, one of the documents that must be presented for payment is a bills of lading, which gives the bank title to the goods and allows the bank to claim the goods if the customer refuses to reimburse the bank without such security interest, the bank's only recourse is against the customer himself. Because of these increased risks, the standby letter of credit is analytically distinct from the traditional letter of credit.[26]

The standby letter of credit is intended as a safeguard against the account party's failure to perform a non-monetary obligation - e.g. the submission of a tender under a construction contract, or the due performance of his obligations under such a contract. But the bank's undertaking to pay is not dependent on actual default by the account party, merely on presentation of the specified documents and in the absence of fraud the bank is not concerned to enquire whether default has in fact taken place. An on demand guarantee fulfils precisely the same function as a standby letter of credit by contract the surety, or conditional, bond is a true guarantee under which the issuer is liable only if there is actual default by the account party.

Documents in letter of credit Transaction

The letter of credit invariably specifies the documents which the beneficiary has to tender to the advising bank in order to avail himself of the benefit of the credit . If the documents tendered by him agree with those listed by the bank in its advice and agree in every respect with the doctrine of strict compliance , no problem arises. But if they differ, a discrepancy of documents occurs. Such a discrepancy raises difficult problems for the bank to which the documents are tendered. It has to decide,usually in an extremely short period of time, whether to reject or accept them or to accept them under a protective mechanism. Moreover, if the advising bank accepts non-confirming documents, either because it does not notice the discrepancy or because, having noted it, considers it as irrelevant, and then passes the documents on but they are rejected by the issuing bank or the applicant for the credit, serious legal difficulties might ensue.

Considering that letters of credit have been known for more than a hundred years and are a common method of payment in international trade, it is astonishing how frequently discrepancy situations arise.

There are cases in which documents tendered by the beneficiary do not correspond to the specifications in the credit and are therefore irregular but the irregularity may be disregarded by the bank. First, the Uniform Commercial Practice (U.C.P.) contains several provisions which sanction the acceptance of irregular documents and these provisions can be invoked by the beneficiary, provided that the credit is operated under the U.C.P. Thus, the credit may require the shipment of 100 tons of particular commodity but the beneficiary. ships only 97 tons and this figure appears in the invoice and the bill of lading. If the credit does not stipulate that the quantity of goods specified must not be reduced, this undershipment is within the tolerance admitted by U.C.P.,[27] consequently the bank should accept the documents but reduce the amount payable under the credit accordingly. Further the credit may expressly prohibit transhipment but the tendered documents, which is a bill of lading, contains on its reverse a printed clause allowing transhipment. In spite of this printed clause, the U.C.P. authorises[29] the bank to pay under the credit. This is a very sensible provision because, in principle, the bank when scrutinising the documents, is not bound to read the small print on the reverse of the bill of lading. In fact, it can hardly arrive at a decision on the acceptance of the documents within a reasonable time if it were bound to scrutinise the small print of every bill of lading tendered to it.

Secondly, irregularities relating to commercial invoices may cause problems It happens sometimes that the description of the goods in the credit and in the invoice do not agree literally but that it is clear that both descriptions relate to the same goods.

This kind of irrelevant variation is totarable under U.C.B.[30] This view is also supported by the following statement of Schmitt Loff:

> " If the tendered documents are ambigous, the tender is, in principle, a bad tender. But the bank, when examining the tendered documents, should not insist on the rigid meticulous fulfilment of the precise wording in all cases. If properly read and understood, the words in the instructions and in the tendered document havethe same meaning, if they correspond though not being identical, the bank should not reject the documents"31

Thirdly, the courts consider the irregularity to be irrelevant. A typical illustration is Golodetz & Co. Inc. v. CZarnikow- Rionda Co. inc. The Galatia,[32] This case concerned the sale of sugar from kandia in India to Iran. The sale was on terms C and F. an iranian port. In order to perform the contract, the seller bought a quantity of sugar from the State Corporation of India Ltd. This supply contract was F.O.B. indian port, payment by the letter of credit. The buyers in the Supply Contract was F.O.B. Indian port, payment by the letter of credit. The buyers in the supply Contract (sellers in the Iranian Contract) opened a letter of credit in favour of State Trading Corporation, the goods to be shipped in the Golatia, which was to load at Kandia. When the vessel was partly loaded fire broke out and a large quantity of the sugar already on board was damaged by the fire itself and the water used to extinguish it. The damaged sugar was discharged and the following note was typed on the bill of lading.

> "Cargo covered by this bill of
> lading has been discharged
> Kandia view damaged by fire/
> and/or water used to extinguish
> for general average declared."

The bank refused to take up the bill of lading on the ground that in view of the above note on it was a claused bill. The court of Appeal held that the bill was a clean bill because the note on it referred to an event which had occurred after the goods were loaded in good order and condition. The Court preferred the legal view to the commercial view, according to which every bill, which contains a notation or clausing, is automatically to be regarded as a claused bill. The same test has been applied in Westpac Banking Corp. v. South Casolina National Bank.[33]

Where the discrepancies are relevant, the bank has no other option but to reject the documents. Hence, if the credit is operated under U.C.P., the tendered documents must satisfy the conditions laid down in document. In these cases the U.C.P. should be the bible of the banker. He should consult it constantly. Of course, many provisions of U.C.P. begin with the words, " unless otherwise stipulated in the credit". Consequently the banker, who notices something unusual in the mandate in order to ascertain whether it covers the deviation from the usual practice.

It is an obvious and gross discrepancy if the credit calls for "Shipped on board", bills of lading is only received for shipment". Of course by notation a received for shipment can be converted into an 'on board bill. But it has to be dated and signed or initialled by the carrier or his agent. If the notation is not in order the bank is bond to reject the documents.[34]

The documents should be properly linked together.[35] Linkage means that the documents must make it plain that they all refer to the same goods. The documents must thus indentify the goods. If there is an ambiguity, i.e. if some documents may refer to other goods, the tender is bad and the bank should reject the documents. In Soproma S.P.A. v. MARINE and Animal By-products Corporation,[36] a case, which concerned the sale of Chilean fishfull meal, the credit required a bill of lading marked " freight pre paid" and an analysis certificate stating that the goods had a content of minimum 70 percent protein, but the tendered documents included a bill of lading marked "collect freight" and an analysis certfficate showing a protein content of 67 percent minimum. The documents were rejected as defective by the bank.

Professor Clive M. Schmitthoff's observation regarding the discrepancy in letter of credit transaction is as follows:[37]

> " The bank deals with a vast multitude of letter of credit transactions all over the world and the decision must be rapid. In case of doubt or ambiguity the safest course is for the bank to reject the documents. It would be within his rights to do so. But one cannot always insist on ones rights. Rejection of documents invariably causes difficulty to the beneficiary of the credit. He may be valued customer of the bank or a businessman of unpeacable reputation and good financial standing or the discrepancy of the documents may, in the judgment of the bank, be of peripheral character. In these

> circumstances the bank has to perform a balancing act. On the other hand, it incures a risk if it accepts non-confirming documents. On the other hand, it does not want to make unnecessary difficulties. Here the bank has to take a very difficult decision. Things often look different from what they appear to be when first uncountered. The possibility that later the transaction is examined under the microscope of the law cannot be disregarded by the bank when making its decision.
>
> In these difficult cases the bank has essentially two possibilities, either to reject the documents or to accept them under a protective mechanism".

The object of payment against documents before goods arrive is to enable the purchaser to deal with documents representing the goods before the goods themselves arrive. To hold that the issuing bank might make the purchaser liable on documents which did not represent the goods, because at sometime latter the goods themselves arrived, seems entirely to defeat the commercial objects of the transaction.

The bank must protect his customer's interest as the purchaser of the goods represented by the documents and in the absence of specific authority as to documents, they must be the usual documents required in the trade and must be merchantable.

To quote Viscount Sumer:

> "The documents have to handled by banks, they have to be taken upon or rejected promptly and without any opportunity for prolonged inquiry, they have to be such as can be retendered to sub-purchasers, and it is essential that they should so conform to the accustomed shipping documents as to be reasonably and readily fit to pass current in commerce. 38

The contract guarantee has, therefore, the difficult task of creating a fair equilibrium among the legitimate interests of the parties (principal, beneficial and guarantor) and of defining the rights and obligations of the three parties with precision to avoid disputes. Unfortunately these concepts have not always been appreciated or applied in practice. Lack of experience in certain cases, or abuse by one party of its dominant position in other cases, has tended to create inequitable situations, heading to dispute and distrust. This state of affairs is a hinderence to the development of international commerce. 40 The Uniform Rules Centre the equilibrium on the need for appropriate documentation to support a claim. By this means it is sought to protect the principal from liability because of unjustified calls on the guarantor by the beneficiary, while both the guarantor and the beneficiary know what documentation must be prepared and presented before there can be payment under the guarantee.

A clear provision on the lines of the Uniform Rules,[41] which concerns the documentation required to support a claim to prevent abuse by unscrupulous beneficiary should be inserted in the contract between the seller and the buyers. The uniform rules provide that evidence of default by the principal is required to justify the honouring of a claim under a contract of guarantee. So far, as possible, the guarantor will be well advised to require documentation prepared independently of the beneficiary, and in a form capable of verification by the guarantee.[42]

The truth of the matter is that the courts decline to be tied to a particular academic principle when dealing with the discrepancy of documents. This branch of law is too multiform to admit generalisation when a problem of discrepancy of documents arises, the facts of the case are decisive. The scorch for a general principle underlying all these cases would be fruitless.

The beneficiary must learn to understand the banks point of view. He must realise that the bank rejects non conforming documents not for petty bureaucratic reasons but because it wishes to avoid personal liability. The documents tendered to the bank should be standardised, to a large extent, and standardised on a global basis. Although discrepancies in documents can and should be reduced, it would be unrealistic and an idle dream to assure that they can be eliminated entirely.

Bank/ Performance guarantee

Bank guarantee, or properly styled these days as performance guarantees by banks, have become a Catchward in the trade. As a service to their customers, banker sometimes issue guarantees and indemnities of various types on customer's behalf to third parties. Performance guarantees are given to government or public bodies on behalf of contractors undertaking the payment of penalty (say, 10% or 20% of the cost project), in the event of non-fulfilment of the contract.

The Jammu and Kashmir State Financial Corporation also gives performance guarantees for loans raised by industrial concerns, which are repayble within a period not exceeding twenty years and are floated in the public market. The corporation also give bank guarantee for loans raised by industrial concerns from schedule banks or State co-operative banks.[43] In a performance guarantee, bank does not undertake to perform the contract itself but will only make good the loss suffered by the creditor to the extent of amount agreed to in the guarantee.

Bank guarantees in internal and international trade are common features of commercial practice. Transactions involving financial liabilities of some magnitude are now almost invariably accompanied by bank guarantees. In India until recently, business on a large scale was confined to a few large cities. The position has now changed with an accelerated progress of development, the variety and magnitude of commercial activities have expended. Large scale construction and collaboration contracts involving huge financial outlays have naturally increased the need of taking guarantees from banks, mostly for tenders and performance.

The purpose of guarantees by banks are many. These include performance of a contract, repayment of a loan, repayment of an advance payment made in respect of a contract involving the sale goods and so on.

Purpose and Function

The undoubted value of guarantee on behalf of a customer is becoming an increasing practical advantage to commerce. In practice the banker who gives the guarantee takes from the customer what, in fact, is a counter indemnity, usually indicating that he is to pay on first demand.

A bank guarantee is an undertaking given by a bank, insurance company or other party (the guarantor) at the request of a tenderer or contractor (the beneficiary) whereby the guarantor undertakes that, in the event of default by the principal in the performance of his obligations, the guarantor shall pay the beneficiary a stated sum of money or (if the contract so provides), the guarantor shall arrange for the performance of the relevant obligations under the tender or contract.

The mention of 'tender ' or 'contract' needs explanation. Bank guarantees may be required (i) in connection with the submission of tenders; or (ii) they may be required after approval of the tender in connection with the performance of the contract. This is why two different lables have come into being - tender guarantee and performance guarantee.[44]

In the case of a tender guarantee the obligations undertaken by the guarantor is to effect that if there is a default by the principal in the obligations resulting from the submission of tender, the guarantor shall make payment to the beneficiary within the limits of a stated sum of money. In the case of a performance guarantee, the object is to safe guard the beneficiary from the consequences of the failure of the principal to meet his obligations under the contract. The international Chamber of Commerce in its Uniform Rules for contract guarantees defines a performance bond as " an undertaking given by a bank whereby the guarantor undertakes in the event of default by the principal the due performance of the terms of a contract between the principal and the beneficiary within the limits of a stated sum of money, or, if the guarantee so provided, at the guarantor's option, to arrange for performance of the contract.[45]

Whether a bank guarantee can be enforced or not by the beneficiary depends on the terms of the contract . If the terms and conditions entitle a party to ask for payment of money from the bank, then that right cannot be interferred with merely for the reason that there exists a dispute between the party and the client at whose instance the bank guarantee has been issued is a stranger to the contract of gurantee between the bank and the beneficiary. If the language of the guarantee entitles the beneficiary to receive payment from the bank, the dispute between the initiating party and the bank would not be a bar for the beneficiary to enforce the guarantee.

The Supreme Court of India has drawn a parallel between the bank guarantee and letters of credit as follows:

> "The rule is well established that a bank issuing or confirming a letter of credit is not concerned with the underlying contract between the seller and the buyer. The courts usually refrain from granting injunction to restrain the performance of the contractual obligations arising out of a letter of credit or a bank guarantee between one bank and other".

So observing, the Supreme Court added:

> "A bank guarantee is very much like a letter of credit. The Courts will do their utmost to enforce it according to its terms. They will not in the ordinary ceurse of things interfere by way of injunction to prevent its due implimentation." 46

Recently the Supreme Court of India in U.P. Coop. Federation Ltd. v. Singh Consultants And Engineers (P) Ltd.[47] has upheld its earlier decision regarding the similarity between letter of credit and bank guarantee. The Court observed that it is true that the Court dealt with a contract to sell specific commodities or a transaction of sale of goods with an irrevocable letter of credit. But in modern commercial transactions, various devices are used to ensure performance by the contracting parties. The traditional letter of credit has taken a new meaning. In business circles, standby letters of credit are also used. Performance bonds and guarantee bonds are also the devices increasingly adopted in transactions. The Courts have treated such documents as analogous to letter of credit.

To the same effect is the observation of Lord Denning M.R. in Edwood Owen Engineering Ltd. v. Barclays Bank International Ltd.,[48] It was observed as follows:

" All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank who gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relation between the customer and the supplier, nor that the question whether the supplier has performed his contract obligation or not; nor that the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions".

Pesticides India v. S.C. and P Corporation of India,[49] raised the question of performance guarantees by bank, particularly in the light of the absolute nature of liability of the principal debtor, on whose behalf the guarantee was given. Quoting Lord Denning M.R.[50] the instant court said, " it is virtually a promissory note payable on demand". According to the instant court the unqualified terms of the guarantee could not be interferred with by the courts, irrespective of the existence or non-existence of the dispute.

There is a lone decision of the Calcutta High Court, namely, MMTC v. Suraj Shetty,[51] wherein it has been held that the distinction between an irrevocable letter of credit and a bank guarantee was not merely one of function. The more important point of this distinction was the autonomy of an irrevocable letter of credit and the dependance of a bank guarantee on a contract between the beneficiary of the guarantee and a third party. Payment under an irrevocable letter of credit did not depend on the performance of obligations on the part of the seller except those which the letter of credit imposed. Then the obligation was of the bank to the beneficiary. No third party came into picture. In the case of a bank guarantee, however by definition the third party was always on the scene. Unless there was some act of omission or commission on the part of the third party, payment under a bank guarantee did not became due. In other words a bank guarantee did not enjoy the autonomy of an irrevocable letter of credit.[52]

It is submitted with due respect that the above decision is not correct in view of the ruling given by the Supreme Court.[53] The question whether the undertaking amounts to a guarantee or a letter of credit depends upon the nature of the terms and conditions. Where the liability is absolute and unqualified it amounts to a letter of credit and where it is conditional and qualified it amounts to a guarantee but not a bank guarantee.

This importation of the English Common Law by the Indian Courts would be in the interest of development of business transactions unhampered by pendency in courts and would avoid underhand tricks to which the business parties will resort to, if the courts stood in their way. The development of the theory of performance guarantee, however, would enrich and grow if the businessmen, particularly the creditors, played a healthy role and ignored flimsy and minor contractual irritations in the national interest of business climate.

Professor I.G.Saxena's observation with respect to the bank guarantee is as follows:

> " This case[54] is not a lam-post for laissez faire and ignored the extent to which absolute discreation could be conferred on a party in the teeth of section 29 of the Contract Act and the concept of illusory consideration. One must also take note of the English and Australian curbing legislations, the English unfair Terms Act, 1977 and the New South Wales Review Contract Act, 1980 empowering the Courts to amend the contract at the instance of a party".[55]

A spate of cases, particularly belonging to Delhi[56] and Culcutta[57] jurisdictions with an apex decision which made its debut[58] in 1981 and was reiterated in 1982[59] and 1987[60] have brought out the case law to the fore. Although the primary law has been settled in its essential aspects, there are matters of detail and procedure which still are left at the root. The Indian Contract Act, cost in the traditional mould of the nineteenth century, is barren of specific problems and provisions on the subject and the cases have been decided on the terms and conditions between the parties which have now assumed the position of standard form contracts.

<u>Nature of Liability</u>

Under the systemof bank guarantee, the bank binds itself to pay unconditionally and unequivocally without protest or demur on failure of performance by the principal debtor. The decision of the beneficiary is, under the deed, made final and binding on the bank, so that there is an absolute liability of the bank to perform its guarantee.

The bank which has opened a bank guarantee/ letter of credit is not concerned with the relationship between the seller and the customer, nor with the question whether the seller had performed its contracted obligations or not. The machinery and the commitment of the bank are on different level. The bank must be allowed to honour its commitments under a letter of credit free from interference by the courts, otherwise, trust in international commerce will be irreperally damaged. The dispute as to the sufficiency of the performance between the buyer and the seller cannot be the reason for withholding the payment under a letter of credit. The bank is only required to see whether the event has happened on which its obligation to pay has arisen. Whether the goods that have been delivered are of merchantable quality or not or whether the goods are upto the contract or not or whether they are of the specified quality or quantity cannot be gone into by the bank. Similarly, the question whether the goods casrespond with the description is also a question that must be resolved by the buyer and the seller in an appropriate proceeding. The bank which has given bank guarantee cannot refuse to pay where all the terms of the bank guarantee have been fulfilled to its satisfaction on the plea that the goods are not upto the contract or do not correspond with the description. The bank is not entitled to with hold payment after its obligation to pay has arisen merely because an allegation of fraud has been made against the seller. It is not enough to allege fraud wherever there is a dispute as to quality or quantity of the goods and cannot be a ground on which the bank will be entitled to refuse payment. The buyer must not only allege but clearly establish that the documents that were presented by the beneficiary were forged or fraudulent.

In Vinay Engineering v. Nayveli Lignite Corporation Ltd.[61] these questions were raised;

(i) Whether the guarantees executed by the bank in favour of the 1st respondent were independent contracts?

(ii) Whether the guarantees were conditional or undonditional contracts?

(iii) Whether the 1st respondent had made demand on the bank in accordance with the terms and clauses of the guarantee? The Madras High Court laid down that it is well settled if the bank guarantee is unconditional, the bank has no defence when its guarantee is sought to be enforce. It is the document of guarantee that has to be scared to ascertain whether the guarantee is conditional or otherwise and whether it is an autonomous contract by itself. Ordinarily, the court shall not grant an injunction restraining enforcent save where there is a clear case of fraud of which the bank has notice and where the special equity was in favour of the beneficiary.

The above view is also supported by a decision given by Karnataka High Court in Kudrenukh Iron Ore Co. Ltd. v. Korula Rubber Co. Pvt. Ltd.,[62] wherein it has been laid down that in case of a bank guarantee it cannot be said that the bank is bound to pay notwithstanding the fact that an arbitration is pending between the parties or dispute is started between the parties and notwithstanding the fact that the amount of loss has not been as yet calculated, because every contract entered into will have to be interpreted with reference to the specific terms, phrases and words used in it. If the bond whatever be its nature shows that the bank has undertaken to pay without any demur or contestation on demand, it would be an irrevocable or unconditional contract and the bank is bound to pay the amount to the person concerned notwithstanding the fact that the disputes between the parties are pending. But on the other hand, if the bond which comes up for interpretation before the court, does not contain any irrevocable or unconditional undertaking and does not contain anything to indicate that the payment should be made on demand, the Court should insist on compliance with the requirements laid down by the bond.

Recently Sabyasachi Mukharji and Jagannath Shetty, JJ. of the Supreme Court of India in U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.,[63] have reiterated its view regarding bank guarantee and held that the principles upon which the bank guarantees could be invoked or restrained are well settled. Only in exceptional circumstances would the courts interfere with the machinery of irrevocable obligations assured by banks. In the case of a confirmed performance guarantee, just as in the case of a confirmed letter of credit, the bank was only concerned to ensure that the terms of its mandate and confirmation had been complied with and was in no way concerned with any contractual disputes which might have arisen between the parties. Therefore, the commitments of banks must be honoured free from interference by the courts. Otherwise, trust in commerce, internal and international, would be irreparably damaged. It is only in exceptional cases, that is to say, in case of fraud or in cases of irretereivable injustice to be done, the courts should interfere.

The interest of india's foreign trade requires that indian businessmen and financial institutions should faithfully and honestly fulfil their commitments. This places greater responsibilities on the courts to see that mere technical pleas are not allowed to shake the faith of foreign importers in the honesty and integrity of Indian export houses and their guarantors. Otherwise the foreign customers may be scared of dealing with Indian traders and it may cause loss of foreign trade.

REFERENCES

1. Buyer - This is the person to whom the goods are sold under the sales contract, generally he is the applicant for the credit.

   Seller - This is the person to whom goods are sold under the sale contract. Generally he is the beneficiary of the credit.

   Credit- Opening bank. This is the individual or the firm with which the applicant for the credit arranges for issuing of the letter of credit.

   Issuing bank - The individual or the firm, other than the buyer that writes the letter of credit.

   Drawee bank- This is the individual or firm, other than the buyer, upon which the drafts under the letter of credit are to be drawn.

2. BORISKOZOLEHYK, Commercial Letter of Credit in the AMERICAS, 1966, P. 12

3. P.N. Todd, Sellers and Documentary credits,J. Business Law 1983, P. 470.

4. United City Merchants(Investments) Ltd. v. Royal Bank of Canada and others (1982) 2 All. E.R. 720.

5. A.G. Davis - The Law relating to commercial letters of credit, 3rd Ed. 1963.

6. Halsbury's Laws of England 4th Ed. P. 99

7. Supra Note 3; Omer F. Heaskey, Letters of credit, Harvard Law R., Vol. 32 1918- 1919 ,P.1, William E. Mcdurdy, The Right of Beneficiary under a Commercial letter of credit, 87 Hard.LR,323

8. T.D. Baily SONXCO v. Ross T. Snyth & Co.Ltd.(1940) 56 T.L.R. 825.

9. The Uniform Customs and Practice for Documentary credits (U.C.P.) is a documents of world wide importance. Banks in 165 countries aperate those rules relating to the most frequent means of payment in the export trade. The U.C.P. were first published in 1933. Revised versions were issued in 1951 and 1962. The versian is operation at present is the 1974 Revision. The U.C.P. have been again revised in 1983. The U.C.P. have not the forced law. But most banks operate their credits expressly under the U.C.P.

10. Clive M. Schmitt HOFF, The New Uniform Customs of Letter of Credit, Business L.J., P.193 (1983)

11. Article 22 (2) of the 1983 U.C.P. provides: Unless otherwise stipulated in the credit, bank will accept documents produced or appearing to have been produced:

(i) by reprographic systems;

(ii) by or as the result of, automated or computarised systems;

(iii) or carban copies, if marked as original, always provided that, where necessary, such documents appear to have been authenticated.

12. Anson, Law of Contract, 26th Ed. 1981, P. 375

13. (1952) 1 Q.B. 291

14. (1978) Q.B. 159

15. id., 170

16. Article 3 of 1983 Revision of Uniform customs and practice for Documentary credits provides:

Credits, by their nature, are separate transactions from the sales or other contract (s) on which they may be based and banks are in no way concerned with a bond by which contract(s) even if any reference whatsoever to such contract(s) is included in the credit.

17. Article 4 id. 16 provides:

In credit operations all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents relate.

18. (1958) 2 Q.B. 127

19. Ibid., at ,P. 129

20. (1986) 1 Lloyd's Rep. 21

21. Ibid. at p. 333

22. (1982) 2 W.L.R. 1039

23. See Chapter VII

24. Halsbury's Law of England, 4th Ed. Vol. 3 P.99; Uniform customs provide as follows:

Article 1 :

(a) Credits may be either (i) revocable; or (ii) irrevocable.

(b) All credits, therefore, should clearly indicate whether they are revocable or irrevocable.

(c) In the absence of such indication the credit shall be deemed to be revocable.

Article 2:

A revocable credit may be amended or cancelled at any moment without prior notice to the beneficiary. However, the issuing bank is bound to reimburse a branch or other bank to which such a credit has been transmitted and made available for payment, acceptance or negotiation complying with the terms and conditions of the credit and any amendments received upto the time of payment, acceptance a negotiation made by such branch or other bank prior to receipt by it of notice of amendment or of concellation.

Article 3

(a) An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that the terms and conditions of the credit are complied with.

(i) to pay, or that payment will be made, if the credit provides for payment, whether against a draft or not;

(ii) to accept drafts if the credit provides for acceptance and payment issuing bank or to be responsible for their acceptance and payment at maturity if the credit provides for the acceptance of drafts drawn on the applicant for the credit of any other drawee specified in the credit;

(iii) to purchase/ negotiate, without recourse to drawers and/or bonafide holders, drafts drawn by the beneficiary, at sight or at a tenor, on the issuing bank, or on the applicant for the credit or on any other drawee specified in the credit, or to provides for purchase/negotiation.

(b) An irrevocable credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of the bank, but when an issuing bank authorised or requests another bank to confirm its irrevocable credit and the latter do as so, such confirmation constitutes a definite undertaking of the confirming bank in addition to the undertaking of the issuing bank,provided that the terms and conditions of the credit are camplied with.

(i) to pay, if the credit is payable at its own counters, whether against a draft or not, or that payment will be made if the credit provides for payment elsewhere;

(ii) to accept drafts if the credit provides for acceptance by the confirming bank, at its own counters, as to be responsible for their acceptance and a payment at maturity if the credits provide for the acceptance of drafts drawn on the applicant for the credit or any other draww specified in the credit;

(iii) to purchase/negotiate, without recourse to drawers and/or bona holders, drafts drown by the beneficiary, at sight or at a tenor, on the issuing bank, or on the applicant for the credit or an any other drawnee specified in the credit, if the credit provides for purchase/ negotiation

(C) Such undertaking, canneither be amended nor cancelled without the agreement of all parties thereto partial acceptance of amendments is not effective without the agreement of all parties thereto

55. (1927) A.C. 711

56. Michael Stern: The independence Rule in stand-by letters of credit. The University of Chicogo LR vol. 52 , P. 218 (1985)

27. Prof. Clive M. Schmitthoff, Discrepancy of documents in letter of credit transactions , The Journal of Business Law, P. 94 (1987)

28. Article 43 (b) of U.C.P.

29. Article 41(c) provides:

"The description of the goods in the commercial invoice must correspondand with the description in the credit. In allother documents, the goods may be described in general terms not inconsistent with the description of the goods in the credit."

30. Article 43 (b) U.C.B.

31. Schmitthoff's Export Trade, 8th Ed. 1986,P.346

32. (1980) 1 W.L.R. 495

33. (1986) 1 Lloyd's Rep. 311

34. Article 27 (b) U.C.P.

35. Article 15 provides:

"Documents which appear on their face to be inconsistent with one another will be considered or not appearing a their face to be in accordance with the terms and conditions of the credit".

36. (1966) 1 Lloy'd Rep. 367

37. Supra Note 27 at P. 105

38. Skandinaviska Akteibo Harget v. Barclays Barclays Bank, (1925) 2 L.R. 523

39. Hansson v. Hamel and Horley, (1922) 2 A.C. 36

40. International Chamber of Commerce (Uniform Rules for Contract guarantees) Publication No.325

41. Ibid, Article 9

42. Aust L.J. Vol. 53, P. 224 (1979) PETER J PARSON

43. See answer to question No.3 of the questionnaire by SFC.

44. PM BAKSHI - Bank Guarantees 3 Camp. L.J.P.121 (1984)

45. Article 2 (b)

46. United Commercial Bank v. Bank of India, A.I.R. 1981 S.C. 426; United Commercial Bank v. Hanuman Synthetics Ltd., A.I.R. 1985 Cal. 96; ACC Babcock Ltd. v. Stram Products Ltd. A.I.R. 1985 Del. 237

47. (1987) 8 Reports (SC) 567

48. (1978) 1 All. E.R. 976

49. A.I.R. 1982 Del. 78; M/s B.L.R. Mohan v. P.S. Coop. S & M. Federation Ltd. A.I.R. 1982 Del.357

50. Supra note 48

51. (1970) 74 Cal. Weekly Note 991

52. Anil Mehta- Guarantees, indemnities, and letters of Credit. The Lawyers Collective, P. 70 1986

53. Supra notes 46, 47

54. Supra note 49

55. Law of Contract, XVIII A.S. I.L. (1982) 75

56. National Oil & Chemical Industries, Delhi v. Punjab and Sind Bank Ltd., Delhi, A.I.R. 1979 Del. 9; M/s Banwari Lal Radhe Mohan v. Punjab State Co-op. Supply and Marketing Federation,Ltd.A.I.R. 1982 Del. 357; Pesticides India v. S.C. and P. Corporation of India, A.I.R. 1982 Del. 78; M/s Har Prashad & Co.Ltd. v. Sudarshan Steel Mills, A.I.R. 1980 Del. 174; Premier Tyre Ltd. v. State Trading Corporation, 1981 Rajdhani L.R.138;

Banwari Lal v. Punjab State Co-op. v. S & M. Federation Ltd. Delhi, A.I.R. 1983 Del. 86; M/s Har Prasad & Co. v. M/s Sudarshan Steel Rolling Mills, A.I.R. 1983 Del. 128; ACC Babcock v. Stream Products Ltd. , A.I.R. 1985 Del. 237; M/s J.R. Enterprises v. M/s State Trading Corporation of India Ltd., A.I.R. 1987 Del. 188.

57. Mineral and Metal Corporation v. Suraj Balaram Sethi, (1970) 74 Cal. W.N. 911; Bird & Co. v. Tribunal Jute Mills (1979) 83 Cal. W.N. 802; Temma Co. Ltd. v. State Bank of India (1979) 83 Cal. W.N. 807; Shreeram Cloth Stores v. M/s Trading Corp. of Bangladesh, (1980) 1 Cal. H.C. Notes 132; Road Machines (India) P. Ltd. v. P.& E. Corporation of India Ltd. ,(Cal.) A.I.R. 1983 Cal. 91; National Project Construction Corp. Ltd. v. M/s G. Ranjan, A.I.R. 1985 Cal. 23; United Commercial Bank v. Hanuman Synthetices Ltd., A.I.R. 1985 Cal. 96; D.T.H. Construction(P) Ltd. v. Steel Authority of India, A.I.R. 1986 Cal. 31; Allied Resins and Chemicals Ltd. v. Minerals and Metals Trading Corp. of India Ltd., A.I.R. 1986 Cal.346; ~~Allied~~ Centax (India)Ltd. v. Vinnor Impex Inc. A.I.R. 1986 Cal. 356;

M/s Banerjee and Banerjee v. Hindustan Steel Works Construction Ltd., A.I.R. 1986 Cal. 374

58. United Commercial Bank v. Bank of India, A.I.R. 1981 S.C. 1426

59. M.S.E.B. Bombay v. Official Liquidator, H.C. Ernakulam, A.I.R. 1982 S.C. 1497

60. Supra note 47

61. A.I.R. 1985 Mad. 213

62. A.I.R. 1987 Kant. 139

63. Supra note 47

CHAPTER - VII

BANK GUARANTEES AND INJUNCTIONS

The function of the Civil Law is not only to lay down or define the rights of the parties but to provide for and grant relief when a person is prevented from realizing or enjoying his rights or when the right has been infringed or in other words, when the corresponding duty is not being fulfilled or has been violated. The highest form of protection which may be expected from or should be aimed by the state is to see that no one encroaches upon or intercepts the rights of another. Failing that, the aim of the Law should be to give a suitor the very thing or nearly equivalent or similar to it as possible which is being or has been deprived.

An injunction is a discretionary remedy, and for the grant of an injunction we have to refer to the provisions of the specific Relief Act and the Code of Civil Procedure. This means that the Courts in India have to deal with injunction not only as an equitable relief but as a relief founded on the basis of law which embodies the principles of injunction.

Letters of credit are now coming into wide spread use as an effective commercial device. More small manufactures and business are engaging in international trade, necessitating their use. Letters of credit are also becoming more common in domestic trade. Most important, however, is the dramatic development of performance guarantee/ bank guarantee used in both domestic and international transactions to guarantee the performance of such contractual promises as construction of roads, sewers, or buildings, maintainance of Sophisticated communication, manufacturing, or other facilities in foreign countries. The spread of credit into nonsale areas, moreover, has just begun. The only limits on their use are the creative abilities of those who use them. In short, performance guarantees are being used in more ways, in more business transactions, than ever before. The telling proof of the broadenced interest in letter of credit law is dramatic increase in the number of reported cases. In the great bulk of these cases the critical issue has been under what circumstances may an injunction issue restraining a bank from making payment on its letter of credit. In other words two questions are important in this regard. Firstly, is there any situation in which the bank is under a duty to refuse payment when requested to do so by the customer? Secondly, if so, when will an injunction lie that orders the seller not to draw under the credit or the issuing banker not to accept or pay?

Corresponding to cases in which buyers try to take advantage of minor deviations known in banking parlance as technicalities, beneficiaries occassionally engage in fraudulent practices such as falsification of bills of lading or other documents of title. When this comes to the attention of the customer or the issuing bank, a thorney legal problem is in the making.

The Courts will only interfere to grant an injunction against the beneficiary of the credit preventing him from receiving payment under the credit if a sufficiently grave reason could be shown, namely forgery or fraud by the beneficiary or by some one for whom he is responsible.

Fraud will be inferred in circumstances when the goods shipped by the beneficiary are of a totally different nature from thos contracted for and the contract of sale as specified in the contract of credit, or the goods shipped contain rubbish. In cases of fraud the court will not compel the issuing or confirming bank to honour the credit because the beneficiary deliberately acts wrongfully in seeking to avail himself of the credit when the knows that he (or a person for whom his responsible) has shipped goods which are not those called for by the terms of the credit.

In accordance with customary law, the bank's duty to verify and subsequently to accept or pay is independent of failure of consideration in the underlying agreement. The issuing banker is, therefore, in an unconfortable position, he knows that the acceptance or the payment he is going to make, although warranted by the law because the documents appear on their face to be genuine, will possibly cause a loss to his customer, especially if the transaction is an international one. If a seller is willing to risk the consequences of a criminal action on fraud, it is quite likely that his assets are either virtually non existant or so well hidden that an action in restitution by the distant purchasers would result in nothing but an expensive academic victory for the purchaser. The banker could became 'technical' himself and pick some deviation, however, slight, in order to avoid payment, but, if there is compliance on the face of the documents the bank would be hard put to make such a claim, especially if the drafts and documents were presented by an intermediary negotiating bank.

Since the development of Modern letters of credit law in the nineteenth century, courts have uniformly held, as a general rule, the issuer's obligation under the letter of credit is independent of any defence the customer may have against payment on the underlying contract. To this rule there is a recognised exception. This exception provides that the Courts will give relief if it is established that the seller is acting fraudulently in the transaction. In Edward Owen Engineering Ltd.[1] v. Barclays Bank International Ltd. Brown L.J. stated the exception as follows:

> "The exception is that where the documents under the credit are presented by the beneficiary himself and the bank knows when the documents are presented that they are forged or fraudulent, the bank is entitled to refuse payment".

Under the Anglo-American Law, the customer should be entitled to the injunctive relief only when he could show irreparable damage, for example, if he had deposited cash with the issuing bank and the bank was in danger of insolvency, but that where the credit was issued merely against the promise of the buyer to indemnify the bank, the former can in no way control the discretion of the bank in paying out its funds under the credit. In <u>Sztejn v. Henry Schsoder Banking Corporation</u>,[2] the plaintiff in New York contracted to purchase a quantity of bristles from a supplier in India. Payment under the contract was to be effected by an irrevocable letter of credit. The letter of credit provides that the drafts by the beneficiary for a specified portion of the sale price would be paid by the defendant bank upon shipment of the merchandise and presentation of an invoice and bill of lading made out to the order of the bank. The letter of credit was delivered to the beneficiary by a correspondent of the issuing bank in India. Both the bills of lading and the invoices described the material shipped exactly as required in the credit as bristles.

The plaintiff alleged that the beneficiary had filled the fifty crates with cow hair and other worthless material and rubbish, with the intend of simulating the merchandise and defrauding the plain-

tiff then alleged that the beneficiary had drawn a draft under the letter of credit to the order of the correspondent bank in sIndia for collection. The correspondent bank presented the draft and documents to the issuing bank for payment. The plaintiff thereupon brought an action seeking that the letter of credit be declared void, and asking for an injunction to prevent of the drafts. Justice Shientag observed:

> " It would be a most unfortunate interference with business transactions if a bank before honouring drafts drawn upon it was obliged or even allowed to go behind the documents, at the request of the buyer, and enter into controversies between buyers and the seller regarding the quality of the merchandise shipped. If the buyer and the seller intended the bank to do this they could have so provided in the letter of credit itself, and in the absence of such a provision the court will not demand or even permit the bank to delay drafts which are proper in form". But he further said:
> "this is not a controversy between the buyer and seller concerning a mere breach of warranty regarding the quality of the merchandise.

> On the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payments, the principle of independence of the banks' obligation under the letter of credit should not be extended to protect the unscrupulous seller It is true that even though the documents or forged or fraudulent, if the issueing bank has already paid the draft before receiving notice of the seller's fraud, it will be protected if it exercised reasonable diligence before making such payment.

The restraint which was granted in <u>SZTezn's case</u> is subject to two important qualifications. First, that the bank which was collecting the draft was merely acting as the agent of the seller. This point is significant because if the drafts had been negotiated to a third party, the court would have not restrained payment. Secondly, the case proceeded on the basis that fraud has been established. The difficulty which most buyers face in practice is establishing that fraud had taken place. When the buyer is merely alleging that the seller has been fraudulentl as opposed to actually establishing fraud, the courts are normally quite reluctant to interfere. Equally, if the drafts drawn under the credit had been negotiated to the holder in due course, the courts again will not interfere with the payment Both these facts were taken into account by Megarry J. in Discount Redards v. Barclays Bank,[3] when he dismissed the buyer's application to stop the issuing and confirming bank from making payment under the letter of credit. In this case, the plaintiff, an English company, ordered from a French Company, 8,625 gramophone records and 825 cassetters. A confirmed irrevocable letter of credit was opened by the buyers through the defendant bank. When the goods were delivered, the plaintiffs found that only 275 records were as ordered and that 75% of the cassetters delivered were not as ordered. The Inspection of the goods was done in the presence of a representative of the bank. The plaintiffs instructed the Bank not to pay on the ground that the seller had acted fraudelently. Counsel referred to Sztejn's case for the proposition that where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit aught not to be extended to protect the unscrupulous seller. In dismissing the application, Megarray J. distinguished Sztejn's case on two grounds. First, that Sztejn's case was dealing with established fraud and secondly in that there was an absence of any possible holder in due course.[4] He said:

> " In the present case, there is, of course, no established fraud, but merely an allegation of fraud, I do not say that the doctrine of that case is wrong or that it is incapable of extension to cases in which fraud is alleged but has not been established, provided a sufficient cause is made out".

Adding the usual cantion against undue interference with the bank's payment obligations, Megarry J. said:[5]

> " I woubd be slow to interfere with bank's irrevocable credits, and hot least in the spere of international banking, unless a sufficiently grave cause is shown, for interventions by the Court that are too ready or too frequent might gravely impair the relliance which, quite properly, is placed on such credits".

The difficulty of establishing actual fraud has been one of the causes which has prevented the plaintiff from getting an injunction. In United city Merchants (investments) Ltd. v. Boyal Bank of Canada,[6] the House of Lords further decided that a plea of fraud will only apply if the person applying for payment is a party to the fraud. The plaintiff in this case agreed to sell to peruvian buyers equipment for a glass fibre making plant. Payment was to be by way of a letter of credit. The contract of sale provided that shipment was to be made on or before December 15, 1976. The goods were loaded on boardship at Flenźåtowe on December 15, but the loading agents issued a set of bills of lading on December 15, stating that the goods were"received for payment". The defendant bank objected to the bills of lading on the ground that they were not on board bills of lading. The carriers freight brokers then issued a fresh set of bills of lading stating that the goods were loaded on board ship at London on December 15. The bank again refused to pay, this time on the ground that they had information which suggests that shipment had not been made on the date stated in the bills of lading. In an action by the plaintiffs against the bank, the bank contended they were under no obligation to pay if the documents presented although conforming on their face with the credit, nevertheless contain some statements of material facts which were not accurate. This contention was rejected by the House of Lords on the ground that to accede to it would undermine the whole system of financing international trade by means of documentary credits. Lord Diplock said:

> " The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim exturpi causa non orifur actio or, if plain English is to be preferred, fraud unravels all". The Courts will not allow their process to be used by a dishonest person to carry out the fraud. The instant case ,however, does not fall within the fraud exception".

In spite of the fact that the Courts have expressly acknowledged the existence of the fraud exception, they have, however, shown extreme reluctance to apply the rule lest any damage be done to the confidence in this system of payment. As in the case of Bolivinter Oil S.A. v. Chase Manhattan Bank,[7] the court granted an injunction against the beneficiary of the credit of a performance bond but left the bank free to honour their obligations if they chose to do so. The plaintiff's in this case were freight contractors who entered into an agreement with Homs, an Iranian Company to carry 238 million tons of Iranian crude Oil to Syria. The plaintiffs' gave Home a performance bond for US $ million payable at your first request without any other producers whatever from your side". There was some delay in the performance of this contract and Homes made a claim on the plaintiff. The parties entered into second freight agreement and it was agreed that the performance guarantee would be released upon the arrival ofthe cost vessel carrying oil to Syria. The plaintiffs agreed to provide Homes with a letter of credit for US$ 4.3 million to cover their disputes. In spite of the argument Homes made a claim under the performance guarantee. The plaintiffs obtained injunctions against Homes, the issuing bank and the confirming bank, the commercial bank of Syria from paying out on the performance guarantee. Staughton J. discharged the injunctions against the issuing and confirming bank in a subsequent hearing and the plaintiff's appealed against this decision. The plaintiffs contended that the injunction was sought to prevent the beneficiary from profiting from his own fraud. The court of Appeal decided that this was not a case of established fraud.

It is clear from the above decisions that courts maintain a great and fundamentally important separation between the rights of the parties under the underlying contract and the rights of one of them under the independent banking contract.

Whether fraud has been established in any given case is a question of fact and closely related to this is the question of the burden of proof that lies on the plaintiff before a case of fraud is made out. The issue was considered by the court of Appeal in United Trading Corporation v. Allied Arab Bank.[8] The plaintiffs in this case contracted to supply Agromark, a state enterprise in Iraq, with eggs, chicken, lamb and beef. A total of 19 contracts, worth some US $ 950 million were involved. The plaintiffs provided the buyers with a performance guarantee of 10% of the total value of the contract. The guarantee payable unconditionally against any claim for damages was given by Rafidian Bank in Iraq on behalf of the plaintiffs. The buyers made a claim under the performance bond and the plaintiffs sought an injunction against the issuing and the confirming bank to restrain them from paying under the guarantee. The plaintiffs contended that the buyers were acting fraudulently in that the claims related to contracts which had been satisfactorily performed many years before. The court of Appeal was of the view that the plaintiffs have established a seriously arguable case that fraud had occured but on the balance of convenience, they would not grant the injunction. Ackner L.J. said,[9] The evidence of fraud must be clear, both as to the fact of fraud and as to bank's knowledge. The mere assertion or allegation of fraud would not be sufficient. The Courts require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for evidence of fraud to be clear, courts would also expect the buyer to have been given an apportunity to answer the allegation and to have failed to provide any, or any adequate answer in circumstances where one could properly be expected. Where the Courts consider on the material before it the only realistic inference is that of a fraud. Then the seller would have made out a sufficient case of fraud.

Commenting on the reluctance of the courts to apply the exception in practice, Ackner L.J. observed:

> "Moreover we would find it an unsatisfactory position if, having established an important exception to what had previously been thought an absolute rule, the courts in practice were to adopt so restrictive approach to the evidence required as to prevent themselves from intervening were this to be the case, in pressive and high sounding phrases such as fraud unravels all".

It is well recognised that letter of credit lore their economic viability if they are constantly subject to delay or uncertainty. Letters of credit work well only if payment under them is prompt and inevitable when the beneficiary's documents are in order. Commercial law has always recognised the high cost of fraud, however, and some courts are justifeably concerned that the credit not become a device for perpetrating fraud. In cases of fraud, courts have been willing to resort to their equity powers to delay payment of the credit unfortunately, courts are not in a position to know whether an account party's claim of fraud is valid, and sometimes are properly reluctant to entertain the fraud defence of an issuer or of an account party seeking to enjoin honour of the credit. The fraud inquiry entails considerable investigation and time, if courts delay honour of credit until the parties have litigated the fraud issue, the credit will not survive as an efficient commercial device and will not achieve some of its significant commercial functions. Although there is a split of authority on the scope of ffaud question, even those courts that given the fraud defence broad scope acknowledge that the costs of doing so are high.[11]

Section 5-III(1) of the Uniform Commercial Code imposes on the beneficiary of a letter of credit a warranty obligation. The statute provides that the beneficiary transfer or presentation of a documentary drafts or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with.

First, the existence of warranty often gives the complaining account party an adequate remedy at law and should deprive him or her of the Equitable relief so often sought at great expense to the letter of credit transaction. Second, the warranty gives independent significance to the beneficiary's certificate common in performance guarantee transactions and thereby over-comes the implication that the purpose of the certificate is to give the account party/beneficiary a fraud defence to a claim for payment under the credit. Third, the warranty relieves the account party from sometimes burden some proof problems in his or her action for damages against beneficiary that has obtained payment under the credit with documents that contain latent defects.

In performance guarantees, the credit commonly requires the beneficiary to certify that the account party has failed to perform his or her executary permission. This is also known as a certificate of inspection. A certificate of inspection is a document which is issued by some one designated and by both parties, or by a third party that is asked to inspect the goods prior to shipment or at the moment of shipment, or whatever is the nature of credit. It may be a construction of something, it may be, now-a-days drilling equipment or whatever, a certificate of inspection is a documents then which says, " I have inspected that which is to be inspected under the credit. I hereby render an opinion that this is in accordance with that was stipulated to be the goods or service to be performed"[12]. The requirement of other documents, and particularly certificates of analysis, quality, weight and the like, is a reasonable precaution for a prudent buyer to take, since he may in this way obtain some measure of assurance that the merchandise is as ordered. Courts unaware of the beneficiary's warranty may be inclined to see these certificates as a protection against the beneficiary's fraud, under this view the account party has insisted on the certificate in order to have a fraud defence should the beneficiary present a false certificate. This view becomes all the more compelling when the certificate referes to the underlying contract by reciting for example, that a sum is due under a contract or a lease. In these cases, the courts are wont to say that the certificate incorporates the underlying contract and opens the letter of credit litigation to the resolution of underlying contract disputes, that is, whether the sum is in fact due. It is important to recognise that the certificate plays an important role in the transaction without serving as a vehicle for entering the underlying dispute in the credit transaction. It is true that the warranty forces the court to look beneath the face of documents but the warranty inquiry occures after the credit is paid and does not interfere with the proper functioning of the credit.

Courts can achieve two desirable results by giving full rein to warranty provisions. First, they can enhance the remedies for a defrauded account party. Second, they can reduce the number of orders restraining issuing bank from paying credits. This first result puts fraud costs on beneficiaries without damaging the credit. The second protects the credit device from the impredictable costs and delays that equitable interference inevitably imposes on credits in general By reducing these costs and delays, courts will enhance to the benefit of all industries that use them.[13]

A commercial letter of credit is independent of the underlying sales contract between the customer and the beneficiary. The issuers responsibility to honour a draft drawn under the credit is not affected by the sellers' breach of warranty concerning the quality or the conditions of goods involved. Thus in the usual course the issuer must honour the draft for payment that complies with the terms of the relevant credit, regardless of whether the goods or documents conform to the underlying contract. However, where the documents or the underlying transaction are tainted with the beneficiary's intentional fraud the issuer need not honour the draft even though the documents comply on their face. A proper definition of fraud will necessarily encompass and be limited by the requirement of scienter, that there be an affirmative, knowing misrepresentation of fact or that the beneficiary state a fact not having any idea about its truth or falsity, and in reckless disregard of truth.

The stand-by letter of credit is useful in such transactions precisely because it allows the parties to shift the risk of unjustified demand from the beneficiary to the customer. This legitimate purpose can best be served by a narrow definition of fraud in the transaction. A strict definition of fraud in the transaction would ultimately made the standby letters of credit more valuable where it is appropriate and thus preserve its usefulness in commercial transactions.[14]

Such a standard would not destroy the commercial utility of letters of credit because it serves no commercial purpose to provide certainty of payment to one who has intentionally deceived other parties to a transaction. Nor would such a standard make injunctions readily available. Not merely fraud be pleaded with particularity, but also the four traditional factors justifying a preliminary injunction must be considered. First the probability that the plaintiff will eventually succeed on the merits; second, the presence of irreparable injury to the plaintiff; third, the injury to the defendant if the injunction is granted; and, finally, the interest of the public or third parties.[15]

It is clear that the fraud exception is now firmly recognised by the English Courts. In spite of this recognition one seases an extreme reluctance by the courts to apply it in practice for fear that irreporable damage would be done to the system of payment that has grown up with the letter of credit. The Courts have strived to maintain confidence in this system of payment at the expense of a few individuals who have entered into inexpedient contracts and this is by no means a bad thing.

The letter of credit to-day is an extremely useful and viable financing device, both in the traditional sale of goods transaction and in the more recent performance guarantee. In the future the letter of credit will become increasingly important in both international and domestic commercial and business transactions. As the letter of credit grows in popularity the principles of law applied to them- must be more fully elaborated if their efficacy is to be maintained. In case of letter of credit of international trade requires presentation of documents prepared independently of the beneficiary. In the case of performance guarantee the documents called for is usually the beneficiary's own certificate that the other party to the underlying transaction is in default there under an open initiation to abuse by the unscrupulous beneficiary. In any event, instances of fraud involving performance guarantee appears to be much rarer than theoretical fears could indicate. Loss of reputation in the international community is a severe and immediate sanction awaiting a dishonest beneficiary.

Indian position

Whether a bank guarantee has become enforceable or not will depend on its terms and the language of the letter of demand. In other words, in case of bank guarantee or a letter of credit the enforceability of such an instrument against the bank depends on the terms and conditions of the same. In practice, the questions that most frequently arise relate to the guarantor's liability. The guaranteeing bank is liable for non-performance of the underlying contract. This much is elementary and flows from the very nature of the contract. But in practice there arises questions of enforcement. Is the guaranteeing bank entitled to demand proof of non-performance, or is it bound to comply with the guarantee as soon as it is called upon to do so ? If the former is the case, then there can possibily arise disputes as to non-performance. This is likely to drag in the conflict between the Principal and the beneficiary in the correspondence between the guarantor and the beneficiary. On the other hand, if the beneficiary and the bank want to avoid such three dimensional controversy, the guarantee can either be made absolute and unconditional or at least some acceptable mechanism for concrete proof of non-performance may be laid down in the contract of guarantee.

The same principles of Law which have been adhered to and accepted by the courts in England and the United States have been adopted and adhered to by the courts in India as well. In Ten Maco Ltd. v. State Bank of India and others.[16] it was held that the bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice. The facts of the case where that at the request of the Petitioner company the respondent bank had given an irrevocable and unconditional performance guarantee in favour of the State Trading Corporation of India Ltd. (S.T.C.) which provided interalia that in the event of the company's failure to fulfil their contractual obligations the bank shall pay to S.T.C. on its first demand the guarantee amount without any contestation, demur or pro-test and/or without any reference to the company and /or without questioning the legal relationship subsisting between S.T.C. and Texmaco. The guarantee was later invoked by the S.T.C. and asked the bank for full payment.

the petitioner company there upon filed a suit. A question, therefore, arose whether the Texmaco was entitled to the injunction as asked for, restraining the bank from making any payment to the S.T.C. in pursuance of the performance guarantee.

The Court said that in the absence of any special equities and the absence of any clear fraud, the bank must pay on demand, if so stipulated and whether the terms are such must have to be found out from the performance guarantee as such. Though the guarantee was given for the performance by Texmaco in an orderly manner their contractual obligation was taken by the bank to repay the amount on first demand and without contestation, demur or protest as without reference to Texmaco and without question the legal relationship subsisting between S.T.C. and Termaco. The performance guarantee further provided that the decision of S.T.C. as to the liability of the bank under the guarantee shall be final and binding on the bank. It has further stipulated that the bank should forthwith pay the amount due " notwithstanding any dispute between S.T.C. and Texmaco." In that context the moment a demand is without protest and contestation the bank is obliged to payirrespective of any dispute as to whether there has been performance in an orderly manner of the contractual obligation by the party. There was no question here of any fraud or equity entitling Texmaco to an injunction.

Another case on the subject is National Oils and Chemical Industries, Delhi v. Punjab and Said Bank Ltd., Delhi.[17] In this case it was contended that a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes on the bank an absolute obligation to pay irrespective of any dispute which there may be between the parties and it would be wrong for the courts to interfere with that established practice by granting and in confirming the injunction, because an eleborate commercial system has been built upon on the footing that the banker's confirmed credit raises an assurance that nothing will prevent the vendor from receiving the price, that the character-istic feature of the irrevocable credit is its own independence of the contract for sale and of contract between the banker and the buyer and that another important feature is the duty of strict compliance being a mechanism of great importance in international trade, interference with which is bound to have serious repercussions on the international trade in the country and that the letter of credit being the life blood of international commerce and except possibly in clear cases of fraud of which the banks have notice, the courts ought to leave the merchants to settle their disputes under the Contract by litigation and arbitration available them as stipulated in the contracts, the courts being not concerned with the difficulties of the merchants to enforce their claims because these are the risks which the merchants take.

In case there are serious allegations of fraud on prima facie examination of the said allegations in the light of the averments of the parties, the matter cannot be allowed to rest at that and deserves to be fully probed and determined. In such a case the principle of independence of bank's obligation under the letter of credit is not to be extended to protect the unscrupulous seller.

Pesticides India v. S.C. and P. Corporation of India,[18] raised the question of performance guarantees by banks, particularly in the light of the absolute nature of liability of the principal debtor on whose behalf the guarantee was given. In the instant case the facts were:

We the State Bank of Bikaner and Jaipur, Udaipur bind ourselves unconditionally and irrevocably guarantee and undertake that in the event of any default/ failure on the part of the Actual user/ Allottee to observe all or any of the conditions prescribed/ to be prescribed by you. We shall on your first demand without protest or demur and without reference to the Actual user/Allottee and notwithstanding any contestation by actual user/Allottee or existence of any dispute whatsoever between you and the Actual user/ Allottee pay forth with to you that you may demand.

It was held that the bank was bound to pay on the first demand without any contestation by the Pesticides India, the principal debtor. Thus according to the Court the unqualified terms of the guaranttee could not be interfered with by the courts, irrespective of the existence of the dispute.

The above has been supported by the Supreme Court in Centeen (India) Ltd. v. Vinmor Impex Inc.[19] The point before the Supreme Court was whether in view of its earlier decision in United Commercial Bank v. Bank of India,[20] it could interfere to grant injunction for the enforcement of the bank guarantee. The sellers, a

Singapore concern, agreed to sell high density polythene to the buyer, an Indian Company, Cantex (India) Ltd. on the basis of an irrevocable letter of credit in favour of the former. The buyer complied with the condition. The seller failed to forward, through bank, the original bills of lading, marine insurance policy, signed invoices etc. to enable the buyer to take the delivery of goods. The buyer secured bank guarantees in favour of the shipping Company, where-after the latter released the goods to the buyer without furnishing to it the above documents. The buyer receive the goods, sold them and realised the sale proceeds. But no amount was paid to the seller. The buyer brought a suit for restraining the bank from paying the money on the alleged ground of inferior quality of goods. The Supreme Court held that the balance of convenience was that the injunction should not be granted, Affirming the decision of the High Court the Supreme Court held that commitments of banks must be allowed to be honoured free from interference by the courts, otherwise, trust in international commerce would be irreparably damaged.

The courts usually refrain from granting injunction to restrain the performance of the contractual obligations arising out of a letter of credit or bank guarantee between ane bank and another. If temporary injunctions were to be granted in a transaction between a bank and a banker, restraining a bank from recalling the amount due when payment is made under reserve to another bank or in terms of the letter of credit executed by it, the whole banking system in the country would fail. In view of the Banker's obligation under an irrevocable letter of credit his buyer customer cannot instruct him not to pay.

In the following cases the enforcement of bank guarantee as a quick mode of recovery of sums due under the printed terms of the contract has been considered and the law is almost settled.

In National Project Construction Corporation Ltd. v. M/s G. Ranjan,[22] the bank guaranteed the recovery of the sumof Rs. 3,50,000 by the petitioner.corporation. The bank guarantee provided if the said contracter fails to utilise the said advance for the purpose of contract we the Bank of Baroda, hereby unconditionally and irrevocably undertake to pay the corporation on demand and without demur and any claim made by the corporation on us for the loss or damage caused to or suffered by reason of the corporation not being able to recover in full the said sum.

The trial court issued an injunction restraining the corporation from enforcement of the bank guarantee. The Calcutta High Court allowed the revision application and set aside the order of injunction. The Court cited with approval the decision of the Supreme Court in MSEB Bombay v. Officaal Liquidator,[23] The Court held thus:

> " The petitioner is entitled to fall back upon the bank guarantee when the balance sum had not been paid petitioner's right to realize that balance is not dependent upon adjudication of the dispute to arbitration. To this extent, the bank guarantee can very well be enforced on its own terms."

The law is thus settled that extraneous claims and counter claims do not injunct the enforcement of the bank guarantee. The enforcement depends upon its terms and conditions.

In a recent case D.T.H. Construction (P) Ltd., v. Steel Authority of India.,[24] the Calcutta High Court refused to issue an injunction restraining the enforcement of bank guarantee. The contract in the instant case was for dredging and deepening a reservior and the plaintiff received from the defendant No.1 Rs. 30 lakhs for bringing machinery for the work. A survey revealed that the reservoir could neither be dredged nor deepened because of the brick, railway tracks and rocks under neath. The judge did not accept the contention of the bank that under section 56 the guarantee was rendered void an account of impossibility of performance. The Judge observed:

> Even if the main contract between the plaintiff and defendant No.1 was entered into by the plaintiff on account of lackof knowledge of certain facts by the defendant No.1 or even because of misrepresentation made by defendant No.1,the bank could have no say in the matter. This is now well established by several decisions of this court as well as the Supreme Court and of the English Courts. 25

The decision correctly follows the judicial precedents and is grounded on the theory that the contract between bank and defendant No.1 was independent of the Contract between the plaintiff and defendant No.1[26]

Again, in United Commercial Bank v. Hanuman-Synthetices Ltd.,[27] the latter agreed to buy from a

Singapore concern specified quantity of vis core staple fibre. The purchasers opened an irrevocable letter of credit at the Central Bank of India in favour of the seller. The United Commercial Bank Singapore, paid the amount against the documents for the goods shipped and forwarded them to Central Bank of India, Bombay. The United Commercial Bank refunded the amount on arrival, the customs authorities declared that the imported stuff was not vis core but polyester fibre. The purchasers asked its bank to repudiate its liability and sought a perpetual injunction against it from making any payment or giving credit to the seller under the irrevocable letter of credit. The Court held that except possibly in clear case of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contract.

If the bank guarantees are unconditional the bank has no defence when its guarantee is sought to be enforced. It is the document of guarantee that has to be scanned to ascertain whether the guarantee is conditional or otherwise and whether it is an autonomous contract by itself. Only in case of a clear fraud of which the bank has notice and where the special equity was in favour of the beneficiary - the courts may grant an injunction restraining enforcement of bank guarantee.[28]

Recently Sabyasachi Mukharji and Jagannatha Shetty, JJ. of Supreme Court have considered the various Supreme Court and High Courts cases in U.P. Co-operative Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.[29] The Court held:

The principles upon which bank guarantees could be invoked or restrained are well settled, only in exceptional circumstances would the courts interfere with the machinery of irrevocable obligations assured by the banks. In the case of a confined performance guarantee, just as in the case of a confined letter of credit, the bank is only concerned to ensure that the terms of its mandate and confirmation had been complied with and is in no way concerned with any contractual disputes which might have arisen between the parties. Therefore the commitments of banks must be honoured free from interference by the courts, otherwise trust in commerce, internal and international, would be irreporably damaged. It is only in exceptional cases of fraud or in cases of irretrievable injustice to be done, the courts should interfere.

The facts of the instant case were that the appellant, a State Government enterprise, on May 17, 1983 entered into a contract, a private limited company for the supply and installation of a vanaspati manufacturing plant at Hardeecharu in the District of Nainital. The contract bond contemplated guaranteed performance of work at various stages in accordance with schedule prescribed therein and provided for completion and commissioning of the plant after due trial run by the May 15, 1984.

Two bank guarantees were executed by the Bank of India, Ghaziabad, and the bank guarantee provided, inter alia as follows:

Now, therefore, the Bank hereby guarantees to make unconditional payments of Rs. 16.5 lacs to the Federation on demand at its office at Lucknow without any further question or reference to the on the seller's failure to fulfil the terms of the sale on the following terms and conditions:

(A) The sole judge for deciding whether the seller has failed to fulfil the terms of the sale, shall be the PCF.

(B) This guarantee shall be valid upto twelve months from the date of issue,i.e. upto June 24,1984.

(C) Claims, if any, must reach the bank in writing on or before expiry date of this guarantee after which the bank will no longer be liable to make payment to PCF.

(D) Bank's liability under this guarantee deed is limited to 16.5 lacs (Rupees sixteen lacs fifty thousand only).

(E) This guarantee shall not be revoked by the bank in any case before the expiry of its date without written permission of the Federation.

And whereas to secure the said advance, the seller requested the bank to furnish a Bank guarantee of the said amount of Rs. 33 lacs (Rupees thirty three lacs) in favour of the PCF and the bank accepted the said request and agreed to issue the required bank guarantee in favour of the Federation.

Now, therefore, in consideration of the aforesaid advance of the said sum of Rs. 33 lacs (Rupees thirty three lacs) to be paid by the PCF to the seller as aforesaid the bank hereby agrees and guarantees to make unconditionally immediate payment to the Federation at its office at Lucknow of the sum or any part thereof, as the case may be, due to PCF from the seller at any time on receipt of the notice of demand without any question or reference to the PCF or to the seller on the seller's failure to fulfil the terms of the said advance.

In the instant case, injunction was sought against the bank and not against the respondents. It was held by the Supreme Court that the net effect of injunction was to restrain the Bank from performing bank guarantee. That could not be done.one cannot indirectly do what one is not free to do directly. But a mal - treated man in such circumstances is not remedyless. The respondent was not to suffer any injustice which was irretrievable. The respondent could sue the appellant for damages. This is not a case where an injunction can be granted. Irrevocable commitment either in the form of confirmed bank guarantee or irrevocable letter of credit cannot be interfered with except in the case of question of apprehension of irretrievable injuatice . This is a well settled principle of law in England. This is also a well settled principle of law in India.

Each case has to be examined in the light of the following:

(1) Whether demands for enforcing the bank guarantees has been made strictly in accordance with the terms of the document concerned; or

(2) Whether there is any allegation of fraud against the beneficiary of which the bank has notice; or

(3) Whether there is any special equity arising out of the particular situation of the case giving rise to a strong prima facie arguable case against enforcement of the bank guarantee or not. This test was applied in M/s *Banerjee and Banerjee* v. *Hindustan Steel Works Construction Ltd*.[30] In the instant case the bank guarantees were given pursuant to the express terms of the contract entered into between the petitioner, a principal debtor and the respondent No.1, a beneficiary, a company for construction of works in the Super power Thermal project. Out of the seven bank guarantees, two were in lieu of security deposit and five were for securing mobilisation advance by the respondent No.1 to the petitioner under the terms of guarantees, for enforcement of the guarantees the respondent No.1 had to make a written demand stating

that the petitioner has committeed breach of any terms of the contract and the extent and the quantum of loss or damage suffered or to be suffered by the respondent No.1 as a result thereof. The decision of the respondent No.1 regarding the quantum of damage was not to be questioned or challanged by the banks or fulfilment of these two conditions, the bank was bound to release the guaranteed amount. However the respondent No.1 while seeking the enforcement of the bank guarantees failed to discharge its duty as the sole judge to quantify the damages and to mention the extent of recoveries made by it although it was within its special knowledge. Although a large amount was recovered by the respondent No.1 there was no whisper about the same in the demand letters.

It was held that by suppressing the material fact from the bank the respondent No. 1 attempted to recover the entire sum under the seven guarantees and the suppression of such material fact in the demand letters have given rise to a special equity in favour of the petitioner to stop payment by the bank on the basis of these demand letters. Although in the petition, there was no allegation of fraud, the said wilful flase representation by the beneficiary that the entire guaranteed amount has become due and payable by suppressing the facts of recoveries already made, was a factor, which must be treated on the same footing as fraud giving rise to a special equity and must be treated as an exception to the general rule that the court should not interfere in these matters.

Similarly in Jute corporation of India v. M/s Konark Jute Ltd.,[31] the principal had given two bank guarantees to the purchasing agent. The principal sought to restrain the purchasing agent of jute from enforcing the bank guarantee and restrain the banks from making payment thereof. The Court found that the balance of convenience was in favour of the principal. It was held that in the peculiar circumstances of the case, the receipt of the money on bank guarantee would ruin of the principal which cannot be repaired. The balance of convenience in such a situation would be in favour of the principal.

The Court also wanted to protect the business of the agent so that the ends of justice were not defeated. It, therefore, held that this could be best done in case the principal secured the commercial rate of interest on the amount on both the bank guarantees for six months to the satisfaction of the trial court.

In M.S.J.R. Enterprises v. M/s State Trading Corpn. of India Ltd.,[32] the bank guarantee provided that the bank hereby unconditionally and irrevocably guarantee that if the Agents fail to perform any of their obligations contained in the contract dated 10.9.1982 including any amendments or modifications to the aforesaid contract dated 10.9.1982 made between the Agents and STC. The bank shall pay forthwith to the STC such amount or amounts as the bank may be called upon to pay subject to the maximum of Rs. 10 lakhs provided that the guarantee herein furnished shall be released and discharged after the expiry of 30 days from the day of the shipment of the post lot of goods, in respect of the export contracts between the STC and the foreign buyers.

It has been held that since prima facie the guarantee stood discharged and although no element of fraud existed yet the guarantee having been invoked after it had prima facie expired. It was a fit case that during the pendency of the suit the injunction was granted restraining the corporation from realising the amount of the bank guarantee.

Although the courts are not concerned with the underlying contract on the basis of which the bank guarantee have been given. Yet the situation may arise where the underlying contract was not concluded one. In such a case the question is , Can there be enforcement of the bank guarantee or not? The Bombay High Court in Kirtoskar Pneumatic Co.Ltd.v. N.T.P. Corpn. Ltd.[33] it was held that there was no contract between the parties to keep to bid alive that the bid could be revoked before the acceptance or the appellant have done, that the respondents did not act to their detriment relying on the bid of the appellants, the bid guarantee could only be invoked if the contract were to be awarded to the appellant's and they had failed to pay the amount or to perform their part which stage never arose. The respondents could not invoke the bid guarantee in terms of the contract and hence a clear prima facie case exists, where in an injunction can be issued whereby the bank is restrained by making the payment. The court further held that the balance of convenience also is clearly in favour of the appellants because even if the above findings are found to be wrong all that would happen is that at the end of the litigation Appealants would be able to recover the amount of the bid guarantee or such other sum as may be determined by the Court. It is nobody's case that the appellant's are not solvent to the extent of bid guarantee and hence all the conditions of issuance of temporary injunction are satisfied.

In M/s Synthetic Foams Ltd. v. Simplex C.P. (India) Pvt. Ltd.,[34] the facts were that the completion of the contract by the plaintiff has been withheld not due to any default of the plaintiff but due to the intervening fire which has taken place at the site. There is nothing to suggest that the plaintiff has committed any default in the performance of the contract or any breach of the terms of the order, where as the perusal of letter filed by the plaintiffs shows that the guarantee was sought to be invoked by the defendant No. 1 on the ground that the plaintiff have not fulfilled the obligation contained in the terms and the conditions of the order, which is misrepresentation of facts.

Secondly, the contract has been cancelled by the defendant No. 1 due to technical reasons and also due to increase in prices rather than due to any fault of the plaintiff.

The bank guarantee was as follows:

> "We, Indian overseas Bank hereby agree and undertake that if in your opinion any default is made by M/s Synthetic Foams Ltd. in performing any of the terms and/or conditions of the order or if in your opinion they commit any breach of the order or there is any demand by you against M/s Synthetic Foams Ltd. then on notice to us by you, we shall on demand and without demur and without reference to M/s Synthetic Foams Ltd. immediately pay to you, in any manner in which you may direct, the said amount of Rs.1,00,000/- (Rupees one lakh only) or such portion thereof as may be demanded by you not exceeding the said seen and as you may from time to time require . "

The court laid down where there are allegations of misrepresentation or suppression of material facts or violation of the terms of guarantee, the courts would not hesitate in granting an injunction. In this content, misrepresentation or suppression of material facts or violation of the terms of the guarantee can be treated as a species of the same genus as fraud. What is necessary that there exists special equity in favour of the plaintiff to grant of injunction. No doubt an obligation of a bank under the bank guarantee is absolute, but such an absolute obligation arises only if the conditions of the bond are satisfied and if the demand made on the bank is in strict accord with its terms and there is no element of fraud, misrepresentation or suppression of material facts involved but where there are allegations of fraud, misrepresentation or suppression of facts made by the party against the beneficiary and there is prima facie evidence to suggest that there is some truth in these allegations then there would possibly be no absolute bar against the courts from granting an injunction restraining the bank from making payment on the basis of the bank guarantee. Similar would be the position where the demand made by the beneficiary is in violation of the conditions of the bond or is not in strict accord with its terms keeping in view the nature of obligation of the bank the terms of the bank guarantee would have to be strictly construed in such cases. Accordingly in the instant case an injunction was granted restraining the defendants from enforcing the bank guarantee.

By enunciating the general principle of non-interference by the courts in respectof the bank guarantee and letter of credit, the courts only intended that the international trade and commerce should function smoothly without interference from court. At the same time, the courts expected that the merchants and traders in international trade and commerce will honour their respective commitments and the business honesty would be maintained. By the theory of non-interference in cases of letters of credit and bank guarantees, certainly the courts did not intend that international trade and commerce should flourish by adopting dishonest unscrupulous practice. These trade practices and the commitments by the banks are treated on a different level by the courts and are allowed to function without interference from courts only with the view that the trust in international commerce is not damaged in any way and not for encouraging malafide activities of unscrupulous traders. If so, fraud or the special equity arising out of the peculiar situation of the case could not have been made exceptions to the general principles of non-interference by courts.

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27. A.I.R. 1985 Cal. 96; The Calcutta High Court noted and approved the decision of the Supreme Court in Tarapore & Co., Madras v. V.D. Tracta Export MOSCOW, A.I.R. 1970 S.C. 891, the Court should not freeze the amount of the irrevocable letter of credit.

28. A.I.R. 1985 Mad. 213; State v. M/s M.K. Patel & Co., A.I.R. 1985 Guj. 179

29. (1987) 8 Reports (S.C.) 567;
In M/s G.S. Atwal & Co. (Engineers) Pvt.Ltd. v. N.P. C. Ltd., A.I.R. 1988 Del. 243, it has been held that where there is a mere allegation without any prima facie proof of fraudulent act- the courts cannot and should not interfere without bank guarantee by issuing an injunction; M/s Escorts Limited v. Modern Insulators Ltd., A.I.R. 1988 Del. 345.

30. A.I.R. 1986 Cal. 374; Allied Resins & Chemicals Ltd., v. M&M. Trading Corporation, A.I.R. 1986. Cal. 346.

31. A.I.R. 1986 Ori. 238; M/s Brul Murugan Traders v. R.C. & F. Ltd., Bombay, A.I.R. 1986 Mad. 161.

32. A.I.R. 1987 Delhi 188

33. A.I.R. 1987 Bom. 308

34. A.I.R. 1988 Del. 207

CHAPTER - VIII

CONTRACT OF GUARANTEE AND FREEDOM TO CONTRACT OUT

The bankers as a part of their business execute guarantees favouring the third parties on behalf of their constituents. These guarantees are called generally "bank guarantees". These guarantees so executed may be either a performance guarantee or a financial guarantee. Performance guarantees are given for the due performance of obligations under a contract by the one on whose behalf the guarantee is issued while as the financial one is issued in lieu of any deposit of money to be made by such person. It is a settled principle of law that the guarantor's liability is co-extensive with that of the principal debtor, it is secondary, arising only out of a default by the principal debtor. The surety occupies a privileged position in law. He can claim to be discharged by certain commissions and omissions on the part of the creditor.

The bank strengthens its own position by the insertion in the guarantee of various clauses whereby the guarantor renounces his statutory rights. These days standard bank guarantee forms are so comprehensively worded that the guarantee is made to contract out many of his normal legal rights. These standard bank guarantee forms contain all types of exclusion clauses. A standard bank guarantee form may be explained as one wherein all or any of the contractual terms have been fixed in advance by, or on behalf of the creditor. It is not possible for a private person to settle the terms of his agreement with a powerful corporation. The question, however, is crucial one. It needs to be determined as to how a party can surrender his legal rights, enshrined in statutory provisions, unless those are made subject to a contract to the contrary or in accordance with the policy of the Indian Contract Act.

It is the usual practice with banks to incorporate in all the guarantees issued by them a clause stipulating the expiry of the date of the guarantee. Further at the end of the guarantee, they incorporate a clause called 'limitation clause' which read in either of the two forms:

(i) Unless a demand or claim under this guarantee is made in writing on or before the (specified date). We shall be discharged from all the liability under this guarantee thereafter.

(ii) Unless a suit or action to enforce the claim under this guarantee is made on us in writing on or before (specified date). We shall be discharged under the guarantee thereunder.

In State of Maharashtra v. Dr. M.N. Kaul,[1] the Supreme Court dealing with limitation clause in the guarantee held that the cordinal rule is that the guarantor must not be held liable beyond the terms of the agreement. The contention that is invariably raised to meet defence the limitation is that the 'limitation clause' inserted in the guarantee deed is violative of the provisions of the Act. It is contended that it is not within the competence of the parties to consent or contract so as to alter either the statutory period of limitation or the statutory starting point of limitation. The time,within which rights may be enforced, being period fixed by the statute, it is not open to the parties by agreement to alter such time, or to waive and contract themselves out of the operation of the statute, limitation being a matter of public policy, consent or waiver is not allowed to defeat it.

No doubt under section 28 of the Indian Contract Act,[2] agreements whidh provide shorter period of limitation than the one prescribed by the law are void, the reason being that such an agreement will absolutely restrict the parties from enforcing their rights after the expiry of the stipulated period, though it may be within the period of limitation. But these agreements must be distinguished from those which do not limit the time within which a party may enforce his rights, but which provide for a release or for feiture of rights if no suit is brought or no claim is made within the stipulated period. The Bombay High Court[3] keeping this distinction in mind had upheld a clause in a policy of insurance which provided.

> "If a claim be made and rejected and an action or suit be not commenced within three months after such rejection...all benefits under the policy shall be forfeited".

The clause was upheld on the ground that it operated as a release or forfeiture of the rights of the assured if the condition was not complied with and a suit could not be maintained on such a policy after the expiry of three months from the date of rejection of the plaintiff's claim. Similarly, a clause that the company shall not be liable if a suit was not brought within 12 months after the occurrence of the loss was upheld as not violative of section 28 of the Contract Act.[4] Construing a similar clause in Government contract providing that the President of India shall be discharged from all liability under the contract unless an arbitration or suit is commenced within six months from the expiration of the period, Jammu and Kashmir High Court held in Prithvi Nath Malla v. Union of India,[5] as follows:

> "The distinction may be fine one but it is nevertheless a fundamental distinction. The arrangement in the one case takes it for granted that the right as well as the liability exists but the time for enforcing it is sought to be limited. While in the other case the parties agree that the right as well as the liability shall stand extinguished, if a specified event occurs".

This view was upheld by the Supreme Court in no uncertain terms. Their lordships of the Supreme Court[6] pointed out that an attempt should be made to enforce the guarantee within the period agreed to between the parties and it is impossible to ignore the time limit which is an integral part of the contract.

The same principles that are applicable to the limitation clause in the insurance policies would equally apply to similar clauses in the "bank guarantees". If a party in whose favour the bank guarantee is executed agrees for curtailment of the period and limits his rights to enforce within a particular time, he is bound by the same although under law he is entitled to a larger period of limitation. This view is not also against the law of limitation on the ground that the purpose of the Limitation Act is that the suits are instituted well within a period specified so that it is easy to prove the case.

A Division Bench of the Kerala High Court had an occasion to consider the 'limitation clause' in a bank guarantee in Kerala Electrical and Allied Engineering Co. Ltd. v. Canara Bank.[7] In this case the third defendant, the proprietor of a unit, entered into a contract with the plaintiff company for purchase of 39 motors and offered a bank guarantee of the first defendant bank; duly signed by its Manager, the second defendant, for a sum of rupees 15,000 when part of the bills were not paid, the plaintiff had invoked the guarantee and later filed the suit for its recovery. The main contention of the bank was that no claim could be made under the bank guarantee as the plaintiff lost his rights under the said guarantee as he did not institute the suit within a period of six months from the date of the expiry of the period of guarantee. The trial court found that since the suit was filed after one year and six months from the date of expiry of the bank guarantee, the plaintiff lost all rights under it and hence could not enforce the claim against the first and the second defendants. The trial court, however, found the third defendant liable. It is the above judgment and decision of the trial court that were challanged by the plaintiff in this appeal. Clause 6 of the bank guarantee dated 16th Jan. 1970 read as follows:

> " This guarantee will remain in force for a period of one year from the date hereof and unless a suit or action to enforce claim under the guarantee is filed against us within six months from the date of expiry of (the guarantee), all your rights under the said guarantee shall be relieved and discharged from all liability thereunder".

The learned judges of the High Court upheld the validity of the limitation clause in the guarantee deed.

A condition in a contract that the rights thereunder accruing to a party will be forfeited or released if he does not sue within a time limit specified therein will not offend section 28. This is because, as per the contract itself, the rights accrued to the party cease to exist by the expiry of the limited period provided for in the contract. In such a case, in effect, there is no limiting of time to sue so, an agreement which provides for a simultaneous relinquishment of rights occured and the remedy to sue for them will not be hit by section 28. But at the sametime an agreement relinquishing the remedy only, by providing that if a suit is to be filed that should be filed within a time, the time limit being shorter than the period of limitation under the Limitation Act, 1963 will be hit by section 28 of the Indian Contract Act.

Therefore, it is open to any two parties to agree that the promisor would only be liable if he is informed of the indemnification within the stipulated period and there seems to be a great deal of sense in it. Lapse of time may result in all kinds of claims which are not capable of determination. With any account of exactitude and when memories of men may become rather hazy. A clause limiting the period to file the suit does not defeat any provisions of law, it is not opposed to public policy and it neither contravens the Contract Act, nor the Limitation Act.

Another important clause is one in which the bank takes power to releae or modify securities, renew bills, grant time, discharge or vary arrangement etc. with the principal debtor without the consent of the guarantee and without in any way prejudicing or diminishing the validity of the guarantee. Almost all guarantee deeds contain some clauses whereby it is laid down that bank shall have the fullest liberty without affecting this guarantee to postpone for any time or from time to time the exercise of the power of sale or any other power or powers conferred by the Deed of Hypothecation and to exercise the same at any time and in any manner and either to enforce a forbear to enforce covenants for payment of principal or interest or any other covenants contained or implied in the Deed of Hypothecation or any other remedies or securities available to the bank and guarantor/s shall not be released by any exercise by the bank of its liability with reference to the matters aforesaid or any of them or by reason of time being given to the borrower, its successors or assigns of any other forbearance act, or omission on the part of the bank or any other indulgence by the bank to the borrower or by any other matter or thing whatsoever which under the law relating to the sureties would but for this provision have the effect of so releasing the guarantor/s.[8]

In the absence of such power, if the creditor bank, for instance gave time to the principal debtor by a binding contract, the position of the guarantor prejudically affected, for if he paid up under the guarantee his remedy against the principal dabtor would be delayed. Similar considerations would apply if the creditor bank were the accept a composition under a deed of arrangement executed by the principal debtor.

Another clause will state that the guarantee shall be in addition to and shall not be in any way prejudiced or affected by any collateral or other security of any kind. This provision is necessary lest it be argued that other securities were taken in substitution for the security afforeded by the guarantor, or by merging or suspending the debt, have affected the liability of the guarantor, because a guarantor who pays off the creditor's indebtedness is entitled by subrogation to the benefit of any other securities held by the creditor in respect of that indebtedness.

The crucial point is as to how the parties to the guarantee deed can contract out these legal rights. The judicial opinion over this issue is divided. It will be in the fitness of the subject to mention both the opinions in full detail.

In Chitguppi & Co. v. VINAYAK KASHINATH,[9] The guarantee provided as follows:

> " The surety (defendant No.2) undertook to indemnify the firm against all losses, damages, and expenses whatever the plaintiff might suffer by reason or in consequence of any default on the part of the principal debtor Surety (defendantNo. 2) expressly waived allor any of the rights as surety (legal, equitable, statutory or otherwise) which may at any time be inconsistent here with and which he might be otherwise entitled to claim and enforce."

Subsequently the terms were varied without the knowledge and constant of the surety. It was argued that defendant No.2 consented to the variation in anticipation without knowing the nature of the variation. Shah J. held that under section 133 of the Indian Contract Act the variation involves the result that the surety is discharged as to transactions subsequent to the variation. " I do not think that the general clause in the letter of indemnity under which he waived all rights under the statutes canbe read as implying any consent to the variation within the meaning of section 133 or as entitling the plaintiffs to enforce the liability against the surety even though according to law, he is discharged from such liability".

Hayword., J. concurning observed:

> "It seems to me impossible to hold that these provisions of the letter were not in express terms inconsistent with the provisions of the Contract Act. where-ever it has been intended that independent provisions should be permitted, it has always been expressly provided for such provisions by the introduction of the phrase " in the absence of any contract to the contrary" which occur in section 146 and a number of other sections and the Indian Contract Act".

Again in Union of India v. PEARL HOSIERY MILLS, it has been held that the provisions of section 133 are not subject toa contract to the contrary between the parties to the contract. This section is in unqualified terms. It was not necessary to put in the words notwithstanding any contract to the contrary in this section, because whenever the legislature wanted that the terms of the contract between the parties should take precedence over the provisions of any section, the words " in the absence of any special contract" have been inserted in that particular section as has been done in sections 152 and 163 of the Act.

On the other hand in Krishnaswami v. Travancore National Bank,[11] Cl. 9 of the guarantee provided:

> " It is further agreed that any contract between the borrower and the lender by which the lender makes a composition with or promises to give time or not to sue the borrower will not discharge the surety or sureties."

The plaintiff's agreed to accept a sum of four annas in the rupee in full satisfaction of their claim, so that there was as envisgged by clause 9 a compositior It was argued that this composition bond extinguishes the debt to the principal debtor and therefore, there is no debt for which the sureties can be made liable. It was held that although a composition bond between the principal debtor and the creditor extinguishes the debt to the principal debtor it does not absolve the sureties from their liability under the surety bond, where the surety has expressly contracted to remain liable notwithstanding the discharge of the principal and therefore the discharge of the principal debtor cannot be said to be implied discharge of the surety.

The Calcutta High Court has also expressed the same view in Ramjan v. Chief Administrator,[12] where a clause in the guarantee provided as follows:

> "I agree that failure on your part to enforce any of your remedies against the borrower or to observe and perform any of the stipulations contained in the said agreement or any time or other indulgence given by you and the borrower, shall not have the effect of releasing me from my liability under this guarantee. I also agreek that this guarantee shall in no way be affected by your taking or varying or giving up any securities, held by you from time to time in respect of this loan."

It was held that the guarntor could not be held discharged of his guarantee on the ground of indulgence alleged to have been granted by the Government to the borrower. The decision conforms to the express terms of the guarantee deed.

In B.S. Patra v. State Bank of India,[13] where creditor bank failed to take action against principal debtor, in response to letters from surety requesting creditor bank to take steps to realise dues by taking possession of hypothecated goods belonging to the principal debtor. The latter was making speedy arrangements to sell away entire stock with a view to escape his liability. In the guarantee deed it had been agreed that the default on the part of the creditor bank in requiring or enforcing the observance or performance of any stipulated terms should not have the effect of releasing surety and accordingly it was held that the surety is not discharged.

Again in Citibank N.A., New Delhi v. J.K. Jute Mills Co. Ltd., Kanpur,[14] the Delhi High Court disagreeing with Punjab and Haryana High Court[15] held that there was no necessity for the legislature to provide the words in the absence of any contract in section 133 or 135 or 141, because the sections themselves speak of consent of the surety, regarding variance in the terms of the Contract between the principal debtor and the creditor, composition with the principal debtor . In the absence of the words without the surety's consent the words "in the absence of any contract to the contrary would have been surplus. Therefore the rights conferred on the surety under sections 133, 135 or 141 could be waived by specific agreement in the deed of guarantee. As a matter of fact such an agreement would amount to consent within the meaning of these sections.

The Karnataka High Court has recently expressed its opinion in R. Lilavati v. Bank of Baroda,[16] that the Contract Act has created rights and liabilities. But the parties have got a right to contract out of the rights and liabilities mentioned in the Act. This is envisaged by section 128 of the Contract Act. Therefore we do not find words notwithstanding anything contained to the contrary etc. in section 141 of the Contract Act. In the instant case the surety has agreed that she will not claim the benefit given to her under section of the Contract Act. She herself is a party to the surety bond. Therefore it is not open to her now to contend that the said clause is either bad at law or is not enforceable. M/s Mohendra Kumar Chandulal v. Central Bank of India, Ahmadabad,[17] was relied on. It interprets section 151 of the Contract Act what the Gujarat High Court held was that the bailee cannot contract out of the minimum liability imposed under section 151. But section 151 is to be found in chapter IX while section 141 is to be found in Chapter VIII. The rights and liabilities created under chapter VIII are entirely different from the rights and liabilities in Chapter X of the Contract Act.

The surety can waive or relinguish the rights he is entitled to as a surety. He does this by consent. The consent can be inferred or can be express. Section 135 of the Indian Contract Act can be avoided by a clause in the contract that the dealings between the creditor and the principal debtor shall not affect the surety. It would have the effect of avoiding the rule whereby a surety would be released. The consent can be given in advance or after the event.

There is a conceptual difficulty about consent in advance. It can be argued how could a party consent to something that has not happened because he would not have the requisite knowledge. A party can enlarge the terms of his liability and give a blank cheque to the creditor. If he wants any restrictions imposed it is for him to do so. He can consent in advance by the terms of his suretyship to be liable notwithstanding any variations or modifications. If the bank or the creditor chose to exercise the wide discretionary power the surety cannot complain. He can waive his rights of subrogation and be answerable to pay the full amount of his debt notwithstanding the excess of the limit. His contract to be answerable for the ultimate balance of the debt without taking into account any payments already made has been upheld. If the instrument makes the surety liable for the full amount irrespective of any payment made by him, the debtor, or third parties, the creditor can prove for that amount. The surety can disable himself by express and distinct terms the advantages he has as a surety.

More recently the standard bank guarantee forms are so comprehensively worded that the surety is made to contract out almost all of his normal legal rights. In this context it is worth nothing the observation made in an English case[18] in the judgment of Lord Diplock when he said: " This (that is the standard form contract) is of comparatively modern origion. It is the result of concentration of a particular kind of business in relatively few hands. The terms have not been the subject of negotiations between the parties to it, or approved by a organisation representing the interests of the weaker party. They have been dictated by that party whose bargaining power either exercised alone or in conjunction with others providing similar goods or dervices, enables him to say, " if you want these goods or services at all, these are the only terms on which they are obtainable take-it-or-leave-it."

Subsequent promise stands on a different footing. Originally such promises were declared ineffective for want of consideration. It was later held that the objection for the lack of consideration was unfounded. The promise was valid " not as a Constitution of but the revival of an old debt."

There must be clear evidence of knowledge where acquiescence is alleged against the surety on the other hand it is not sufficient for the surety to allege that he was not informed by the creditor, but he should allege and prove the ignorance of the facts.

To conclude in the well known words of Anson the Law of Contract is that branch of law, which sets a number of limiting principles subject to which parties may create rights and duties for themselves and the whole business of that law is to enforce the contracts which comply with those limiting conditions and principles.[19]

Moreover in England, pursuant to the Law Commission's Report of 1975, the British Parliament had enacted the Unfair Contract Terms Act, 1977. It is time that the Indian parliament followed suit in the interest of the weaker sections of the society at large. The question to be determined is as to the extent to which the law would or should assume that parties would enjoy freedom of economic decision when entering into contracts, particularly when more and more economic activity come under computerisation that the country is being ushered into the twenty first century of our dreams.

REFERENCES

1. A.I.R. 1967 S.C. 1634

2. Section 28 reads as:

   Every agreement, by which any party there to is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent (relevant portionaly).

3. A.I.R. 1914 Bom. 225, Baroda Spg., and Weg.Co. Ltd. v. Satyanarayan Marine and Fire Insurance Co.

4. Ruby General Insurance Co. v. Bharat Bank, A.I.R. 1950, East Punj. 352; Pearl Insurance Co. v. Atma Ram, A.I.R. 1960 Puj. (F.B.)

5. A.I.R. 1962 J.& K. 15

6. Supra Note 1

7. A.I.R. 1980 Ker. 151

8. Clauses 3,4 and 5 of the Deed of Guarantee of the State Bank of India; clauses 2 and 4 of the Deed of Guarantee of the J.& K. Financial Corporation.

9. A.I.R. 1921 Bom. 164

10. A.I.R. 1961 Punj. 281

11. A.I.R. 1940 Mad. 437; Cowper v. Smith, (1838) 4 M&W 519; Union Bank of Manchester Ltd. v. Beech, (1865) 3 H & C 672 Rel. on

12. A.I.R. 1960 Cal. 416; Brahnayya & Co. V. K. Srinivasan, A.I.R. 1959 Mad. 122

13. A.I.R. 1986 Ori. 247

14. A.I.R. 1982 Delhi, 487; ACC Babco-ck Ltd. v. Straw products Ltd., A.I.R. 1985 ,Delhi,237

15. Supra note 10

16. A.I.R. 1987 Kant.2 In Central Bank of India v. B.K. Nayar, A.I.R. 1985 P.& H. 161, it has been held that the rights conferred on sureties by section 133, 134, 135, 139 and 145 of the Contract Act can be contracted out and the surety cannot claim the benefit of the sections.

17. A.I.R. 1984 NOC. 113 (Guj.)

18. Instone v. A. Schraeder Music Pub.Co. Ltd.(1974) 1 W.L.R. 1308,P. 1316

19. Anson's Law of Contract.

CHAPTER - IX

CONCLUSION

A guarantee often demanded by a banker or creditor as an additional security to reinforce a clean advance or buttress a tangible security which, for one reason or the other, is not considered adequate.

A guarantee is one of the simplest forms of security, easy to obtain but replete with legal complications, practical difficulties and considerable unpleasantness, if unfortunately there be need to release it. It is common knowledge that while the guarantor signs the guarantee he hardly thinks of the eventuality that he may be called upon to pay, and is surprised or even annoyed when he is asked by the banker or the creditor to meet his obligation on the fault of the principal debtor. The complaent guarantor had probably never had visualised such a contingency. In an embrassassing situation like this, an attempt is possibly made by the guarantor to get out of the obligation. Even if he is unable to evade the obligation and has ultimately to pay, the transaction often strains his relations with the banks. The best course for the banker would, therefore, be to explain tactfully in the beginning itself to the prospective guarantor his obligations on the guarantee although he (the banker) is not legally bound to do so. It is enough if the guarantor knows he is signing an instrument of guarantee and no other document. It is not necessary for the banker to read or explain to him the different clauses of the memorandum of guarantee. It is sufficient if the guarantor knows the type of transaction he is entering into.

Bank guarantees in internal and external trade are common features of commercial practice. Transactions involving financial liabilities of some magnitude are now almost invariably accompanied by bank guarantees. In India until recently, business on a large scale was confined to a few large cities. The position has now changed with an accelerated proces of development, the variety and magnitude of commercial activities have expanded. Large scale construction and collaboration contracts involving huge financial outlays have naturally increased the need of taking guarantees from banks, mostly for tenders and performance.

In modern commercial transactions, various devices are used to ensure performance by the contracting parties. The traditional letter of credit has taken a new meaning. In business circles, standby letters are also used. Performance bonds and guarantee bonds are also the devices increasingly adopted in transactions. The courts have treated such documents as analogous to letter of credit.

Guarantees certainly have their uses, though they are subject to some inherent defects not found in other securities. A guarantee by a relative or friend or joint and several guarantees from two are more of them may mean that a bank can support a small business with at that time little or no free assets, but with an arbitious and enterprising proprietor who can thereby develop the business over the years into a considerable one whose account and good-will the bank will be pleased to have.

Answers to the questionnaire clearly point out that the banks are playing a leading role in socio-economic development. Almost all sections of the society are the beneficiaries of the bank loans. The financial assistance given under various schemes has defintely brought about a rapid industrilization, provided means of employment opportunity and brought fantastic changes in the socio-economic pattern and liking standard. The cherished goal of a welfare state can be reality if only the majority of the people who live in villages are motivated and involved in developmental activities. Bankers with their resources and proves ability have certainly an important role to play.

Before considering a further expansion of the role of commercial banks in expanding the area of economic welfare, solutions have to be found for a few issues which have surfaced in the course of the post decade of welfare banking. In the first place, one has to take the note of the fact that credit can by itself create nothing. Credit places in the borrower's hands founds that can be used to purchase productive inputs . Several factors have been identified as essential complements of credit in promoting developments. These are opportunities for putting credit to productive use, adequate marketing infrastructure to make investment profitable, availability of necessary inputs in adequate quantities and favourable government policies. Under the circumstances increased availability of credit alone may have little effect on production and income if other factors militate against the profitable use of credit. Failure of borrowers to repay their debts on time or repay them at all, is a serious problem for most of the commercial banks.

Guarantees have both attractions and disadvantages. Banks prefer third party guarantees as compaired to other securities. This becomes clear from the repay to the questionnaire. The reason given is that in case of default the guarantor's pursuation results in the repayment of the loans. By the nature guarantees are as ideosyncratic as the persons giving them, for they cover a wide gamut from fully supported and first class one to wholly unsupported one by persons of doubtful standing taken more in hope than anything else.

Thus by and large, guarantees are not so reliable as other securities which possess an intrinsic value they can be something or a gamble, and the degree of reliance which can be placed on may not be easy to estimate, varying as it does from guarantor to guarantor.

Whether a contract is one of guarantee or indemnity can thus be assumed, sometimes, only by referring to the circumstances which gave rise to the need for the use of that distinction, and there certainly can not be any basis for predecting, at the time a contract is made, into which category it may fall. The question whether the agreement amounts to a contract of guarantee or indemnity is almost a barren controversy and, an unproductive semantic wrangling involving hair splitting distinctions. This role of law and lawyers exposes them to public ridicule and contempt.

The remedy, if any, would seem to lie in ignoring entirely the supposed categories and actually deciding the cases on the particular factual issues presented. But in the absence of such a remedy, it must be recognized that definitions of the guarantee or indemnity are cost in terms of the result rather than in terms that will lead to results.

Whether the obligation of a surety becomes primary one where no liability has ever been fastened on the principal debtor by reason of his minority at the time of the contract or not? The best course open to the courts is that where all concerned parties know that the first promisor (principal debtor) is an infant, so that as against him, the promise cannot be enforced, the court should incline to construe the document signed by the major (the second promisor surety) as an independent contract.

There is considerable conflict of opinion as to whether the past benefit to principal debtor amounts to a good consideration. Though the conflict has not yet judicially resolved the researcher agrees with the view that past consideration or past benefit to the principal debtor should not be good consideration for a contract of sale for the reasons submitted earlier.

Again whether a guarantee is continuing or non-continuing cannot be determined by a rule of or fixed rules of construction, nor by reference to thumb decide cases. They simply illustrate what the courts have done under the peculiar facts and circumstances of particular cases. Disputes frequently arise as to whether an instrument falls within the description of a continuing guarantee or not. There is considerable difficulty in reconciling all the cases on this subject, and the difficulty arises chiefly from their being not at one principle of decision. Some laying down that the guarantee should be construed liberally, in favour of the person giving it and the others, that it ought to be construed strictly. Lord Ellenborough observed, if a party means to confine his liability to a single dealing, he should take care to say so, such a recital would restrain the generality of the engagement, and explain whether it has reference to past or future transactions or continuing with reference to future transactions depends always on the circumstances under which it is given.

A review of some of the situations in which a guarantors liability is not co-existensive with that of the principal debtor showed that the courts have treated such cases as exceptional thereby emphasising the existence of the general principle. However, it also becomes apparant that the exceptions to the general rule are not insignificant in number and importance. It is not easy to find out a common thread in the exceptions. It would, for example, be stretching these concepts beyond breaking point to say that the voidness of a hire-purchase agreement, which is the subject matter of a guarantee, is a vitiating element attaching to the principal obligation, but the ultra-vires character of a transaction, which is the subject matter of a director's guarantee, is a defence personal to the principal debtor. So, too , where a debt is statute barred this has not been allowed to prevent the complete performance of the transaction by obliging the surety to pay the creditor and then reimbursement from the principal debtor, for in this way the contractual rights and obligations of all parties are satisfied and honoured.

It can fairly be said that there has been no rigid application of the general rule that the surety is a favoured debtor, modifications have been made and exceptions created by the courts, but these have been the result of the attempts, not always consistent in the same direction, to adjust the conflicting interests of creditor, principal debtor and surety and also the public interest in favour of the enforcement of contractual obligations formally assumed.

Any alteration in the guarantee should be got duly authenticated by the guarantor. Further as a general rule, the guarantor should be required to sign the guarantee in the presence of an official or officials of the bank. The practice of entrusting the guarantee form to the borrower with a request to get it signed by the guarantor should be discouraged. Once the banks follow this practice a lot of litigation can be avoided between the parties.

The reservation clause effectively nullifies the rule which has been declared to be desirable, namely that a surety is discharged by any alteration in the original contract which varies his risk. Here direct action against the principal debtor is precluded, and the result will may be that the principal debtor will ease all efforts to fulfill his obligations to the material disadvatage of the surety. Thus viration in the surety's risk, affording one basis for discharging the surety when the principal debtor is released, is equally present whether the rights against the surety are or are not reserved. An agreement between the creditor and the principal debtor to which the surety is not a party, should in no way be allowed to prejudice the surety's rights.

The creditor's right to hold the securities until the whole debt has been paid is paramount to any claim of the surety whether based on section 140 or section 141. No surety can step into the shoes of the creditor until he has discharged his liability and until the entire debt due to the creditor has been paid in full. This rule shall apply also where the surety is only for the part of the debt.

When a problem of discrepancy of documents arises, the facts of each case are decisive. The beneficiary must learn tounderstand the bank's point of view. He must realise that bank rejects non-conforming documents not for petty bureaucratic reasons because it wishes to avoid personal liability. The documents tendered to the bank should be standardised, to a large extent and standardised on a global basis.

The contract of guarantee has, therefore, the difficult task of creating a fair equilibrium among the legitimate interests of the three parties (principal, beneficiary and guarantor) and of defining the rights and obligations of the three parties with precision to avoid disputes. Unfortunately these concepts have not always been appreciated or applied in practice. Lack of experience in certain cases, or abuse by one party of its dominant position in other cases, has tended to create inequitable situations leading to dispute and distrust. This state of affairs is a hindrence to the development of international trade. There should be appropriate documentation to support a claim.

A bank who gives a performance guarantee must honour that guarantee according to its terms. Although the primary law has been settled in its essential aspects, there are matters of detail and procedure which still are left at the root. The Indian Contract Act, cast in the traditional mould of the Nineteenth century, is barren of specific problems and provisions on the subject and the cases have been decided on the terms and conditions between the parties which have now assumed the position of standard form contract.

The development of the theory of performance guarantee, however, would enrich and grow if the businessmen, particularly the creditors, played a healthy role and ignored flimsy and minor contractual irritations in the national interest of business climate. The interest of the India's foreign trade requires that the businessmen and financial institutions should faithfully and honestly fulfil their commitments. This places greater responsibilities on the courts to see that mere technical pleas are not allowed to shake the faith of foreign importers in the honesty and integrity of Indian export houses and their guarantors. Otherwise the foreign customer may be scared of dealing with Indian traders and it may cause loss of foreign trade.

In performance guarantee, the credit commonly requires the beneficiary to certify that the account party has failed to perform his or her executory promise. This is, also known as a certificate of inspection. The requirement of the documents and particularly certificates of analysis, quality, weight and the like is a reasonable precaution for a prudent buyer to take, since he may in this way obtain some measure of assurance that the merchandise is as ordered.

The bank guarantee is useful in commercial transactions precisely because it allows the parties to shift the risk of unjustified demand from the beneficiary to the customer. This legitimate purpose can be served by a narrow definition of fraud in the transaction would ultimately made the bank guarantee more valuable when it is appropriate and thus preserve its usefulness in commercial transactions.

Such a standard would not destroy the commercial utility of letters of credit because it serves no commercial purpose to provide certainty of payment to one who has intentionally deceived other parties to a transaction. Nor would such a standard make injunctions readily available. Not merely must fraud be pleaded with particularity, but also the four traditional factors justifying a preliminary injunction must be considered. First, the probability that the plaintiff will eventually succeed on the merits, second the presence of irreparable injury to the plaintiff, third, the injury to the defendant if the injunction is granted, and finally, the interest of the public or third parties.

It is clear that the fraud exception is now firmly recognised by the courts. In spite of this recognition one senses on extreme reluctance by the courts to apply it in practice for fear that irreparable damage would be done to the systemof payment that has grown up with the performance guarantee. The courts have strived to maintain confidence in the system of payment at the expense of a few individuals who have entered into inexpedient contracts and this is by no means a bad thing.

The letter of credit today is an extremely useful and viable financing device both in the traditional sale of goods transactions and in the more recent performance guarantee. In future the letter of credit will become increasingly important in both international and domestic commercial and business transactions. As the letter of credit grows in popularity, the principles of law applied to them must be more fully elaborated if their efficacy is to be maintained. In case of letter of credit of international trade requires presentation of documents prepared independently of the beneficiary. In the case of a bank guarantee the documents called for is usually the beneficiary's own certificate that the other party to the underlying contract is in default there under an open invitation to abuse by the unscrupulous beneficiary. In any event, instances of fraud involving bankguarantee appear to be much rarer than the theoretical fears could indicate. Loss of reputation in the international business community is a severe and immediate sanction awaiting a dishonest beneficiary.

By enunciating the general principle of non-interference by the courts in respects of guarantee and letter of credit, the courts only intend that the international trade and commerce should function smoothly without interference from court. At the sametime, the courts expected that the merchants and traders in international trade and commerce will honour their respective commitments and the business honesty will be maintained. By the theory of non-interference in cases of letters of credit and bank guarantees, certainly the courts did not intend that international trade and commerce should flourish and thereby adopting dishonesty unscrupulous practice. These trade practices and the commitments by the banks are treated on a different level by the courts and are allowed to function without interference from court only with the view that the trust in international commerce is not damaged in any way and not for encouraging malafide activities of unscrupulous traders. If so, fraud or the special equity arising out of the peculiar situation of the case could not have been made exceptions to the general principles of non-interference by courts.

More recently the standard bank guarantee forms are so comprehensively worded that the surety is made to contract out almost all of his normal legal rights.

It is the result of concentration of a particular kind of a business in relatively few hands. The terms have not been the subject of negotiations between the parties to it or approved by an organisation representing the interests of the weaker party. It is like take-it or leave-it situation.

The question to be determined is as to the extent to which the law would or should assume that parties would enjoy freedom of economic decision when entering into contracts, particularly when more and more economic activity come under computerisation that the country is being ushered into the twenty first century of our dreams.

Suggestions and Recommendations

The defects of the guarantees as security centre round (i) the legal complications of the guarantee forms and the rights of the guarantor and (ii) the guarantor's financial ability to honour his guarantee as and when called upon to do so.

To meet the first point bank guarantee forms are drafted with the utmost care to protect the bank as much as possible and likewise to cut down the surety's statutory rights (of course the statute itself making the rights subject to a contract to the contrary). A guarantee is dependable when it is fully supported by other security, whether cash, land, stocks and shares, life policies and so on. But if is partially supported, or as in perhaps a majority of cases, unsupported, then the absence of assets actually charged to the bank makes the guarantee a less dependable security than the other types of security. Of course, even at worst an in supported guarantee makes the bank on the secured creditor of two or more persons instead of one but if neither guarantor(s) nor customer has any assets, nothing can be obtained, and there is often little point in obtaining judgment against then and even less in instituting bankruptcy proceedings. Banks try to avoid taking guarantees from men of straw , and usually make status enquiseins on guarantors at, say, six monthly intervals. Nevertheless, the position of a guarantor apparently, sound when he entered into the guarantee, may change abruptly or gradually without the bank's knowledge. Giving a guarantee on behalf of someone who is indebted to his bank is a onerous obligation often blithely entered into by sureties who never expect that one day they may be called upon to pay up.

The difficulty of keeping in touch with the financial position of the guaranter from time to time contrasts with the case which some other securities can be daily valued, e.g., quoted stocks and shares and with stability in value of such securities as land and life policies. In the case of these other securities the bank has actual control over them, for it normally possesses the appropriate instrument of title, but it has no similar control over a guarantor. Quoted stocks and shares and life policies with a surrender value can be quickly converted into cash, and land can be sold though it may take a little longer, but getting a guarantor to hand over cash is less certain and not always successful. Even wealthy guarantors are sometimes not keen to pay up, and though in case of need banks can and to institute proceedings against relevant guarantors, such legal action may occasionally prove abortive and in any event lead to bad feeling and ill-will between all concerned.

The guarantor should be highly credit worthy. An ideal guarantor is one who can be considered good for clean advance to the extent of the guarantee.

The banker should approach any person to give a guarantee for an advance to a borrower.

In the case of joint, or several guarantees no advance should be made until the signatures of all the proposed guarantors are obtained.

Periodical confirmation of the guarantee should be obtained from the guarantors separately along with balance confirmation duly signed by the borrower to avoid the guarantee agreement becoming time-barred.

No bank should lend to a customer solely relying on a guarantee. Even if, the contract of guarantee, is legally valid, it cannot ultimately produce cash from a guarantor who may be incapable of meeting his liability.

When a banker proposes to accept a guarantee as security for a loan, he must first of all, by careful inquires, satisfy himself as far as is possible that guarantor will be able conveniently and without embarrassment to carry out his promise to pay if the borrower fails to do so. For instance, the banker should not generally speaking regard persons with fixed incomes terminable at death, who have no other means, a fit person to guarantee a loan.

At the time of entering into a contract of guarantee the guarantor may be quite able and willing to perform all that he agrees to do, but his financial position, though no fault of his own, may change for the worse, while the guarantee remains operative, the banker should, therefore, renew periodically his original inquires . He should make it clear to the source of his information that the inquirey is a renewal, since otherwise the latter might think that the guarantor was undertaking an additional liability which he would not be in a position to meet. In particular, the banker should look out for any evidence that the guarantor has settled or is about to settle, any substantial part of his property in trust for his dependents or that he is otherwise placing his property beyond the reach of his creditors.

The guarantor is well advised to require documentation prepared independently of the beneficiary, and in a form capable of verification by the guarantor.

Fraud will always be a problem in any transaction and parties to an international venture must always evaluate the risk of its occurrence and prices the contract appropriately. Obviously factors such as the relative bargaining strength of the parties and how desperately the business is wanted will influence the compromise point. Under standard form contracts often the position is such that one party has to accept the terms put forward by the other party, but if possible the number of options should be considered.

The terms of the performance bond or guarantee should provide that it is only payable on production of some independent evidence of default(e.g. an arbitration award, an independent certificate). The bond should clearly set out when and how the banks should make or refuse payment.

There should always be a term in the underlying contract that written notice must be given by the beneficiary of the bond to the other party before a demand is made that such demand can not be made within a specified period from the date of expiry of the guarantee.

This would give the account party the opportunity to go to the court and seek a remedy to prevent the beneficiary from making an unlawful call when it was felt that this was likely.

Continuance of financial assistance depends on the extent of recovery of loans, duly and expeditiously. If the Financial institutions are compelled to resort to recovery through the suits in civil courts, the process of recovery will be delayed. Therefore the financial institutions should have a expeditious remedy of recovery. As it is clear from the answers to the questionnaire that the banks should have power for the speedy recovery of the loans. This purpose can be achieved if the Indian Arbitration Act and the Land Revenue Act are made applicable to all banks so for as settlement of disputes and recovery of loans are concerned respectively. On the above lined Financial Corporations throughout the country have also been given special powers for the recovery of loans. It is desirable and high time that similar powers are also given to the banks also.

In view of the massive credit facilities extended by the banks debts sometimes get time-barred under the law of limitation. Again short-term loans granted by the banks repeatedly being renewed or re-loaned at the expense of vastman power just to save them from getting barred by the limitation Act. This process involves considerable delay and expense in most of the cases.

Under Article 112 of the Limitation Act, 1963, for filing any suit by or on behalf of the Central Government or any state Government, the period of limitation is prescribed as 30 years. Banks mainly deal with the money of a large number of depositors, besides that of the share-holders. Thus, if the advances made by the banks are barred by limitation, the loss falls on the public, that is on the community in general, while the corresponding benefit, accrues to the private individuals who derive advantage by the lapse of time. Further, due to some inevitable factors, there will be some unavoidable delay in the functioning of the public institutions like banks in the matter of filing suits and pursuing their remedies. Viewed in this background, there is a rational basis for equating the public institutions like banks and other financial institutions, with the Government for the purposes of extending the benefit of the longer period of limitation proved under Article 112 of the Limitation Act.

It is, therefore, submitted that the Limitation Act, 1963 be amended to incorporate the above view. If this concession is not immediately extended to them, they would in all probability lose their credit, on which the very foundations of banking business stand.

The existing law embodied in the Indian Contract Act needs streamlining and suitable modifications the definition of continuing guarantee is ambiguous and the illustrations appended to the section as created confusion. It will be better to revise the definition so as to point out expressly as to what is a continuing guarantee.

The Indian Contract Act relating to the contract of guarantee should be modified appropriately at relevant places so that the rights of the surety are not taken away by powerful financial banks and government under the standard form contract. In England, pursuant to the Law Commissions Report of 1975, the British Parliament had enacted the unfair Contract Terms Act, 1977. It is time that the Indian parliament followed suit in the interest of the weaker sections of the society at large.

A distinction should be embodied between a contract of guarantee and an irrevocable letter of credit as far as the problem of injunction is concerned. Specific provision shall be made that the power to declare whether the principal debtor has committed 'default' or not should not lie with the creditor or his nominee . This is a judicial function concerning the fortunes of both principal debtor and surety. This issue, therefore, be decided by a court of law or at the most by a set of arbitrators and an independent umpire law on the subject should be made clear.

The problem of freedom of contract and standard form contract is a burning problem and there should be a through revision of the whole chapter of contract of guarantee and indemnity on the subject and relevant provisions be made.

There has been a judicial conflict on the following two problems. When the agreement between the principal debtor and the surety is void and the liability of the surety has to be distinct. The Indian Contract Act is amended and expressly it is laid down, that the capacity defence is personal to the principal debtor and should not be pleaded by the surety. If the surety did not know of the incapacity and the creditor knew of the fact and did not disclose it to the surety this may well be a defence based on the non-disclosure of a material fact.

The words any variance in section 135 has divided the Supreme Court between majority and minority. The law may be amended to incorporate the majority view.

An agreement between the creditor and the principal debtor should in no way be allowed to prejudice the surety's rights. The courts should refuse to give effect to the reservation clause in a discharge of the principal debtor. The law should be suitably amended.

The Law Commission in its 13th Report, 1958 did not suggest any sweeping changes on the subject. Three decades have passed since the report was given and second revision of the Indian Contract Act particularly on contract of guarantee is long over due. A number of new factual situations have come before the courts on account of the industrial development of the country.

It would be in the fitness of things if the Law Commission of India takes up the matter of the revision of the Indian Contract Act and the provisions dealing with the contracts of guarantee are revised in the light of suggestions made in this study. This will benefit the trade and commerce and the people of India at large and will be in the interest of the country's development.

APPENDIX No. I

Provisions of Sections 124 to 147 of the Indian Contract Act, 1872

124. "Contract of indemnity" defined - A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity".

Illustration

A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

125. Rights of indemnity-holder when sued - The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor -

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity,

or if the promisor authorised him to bring or defend the suit;

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

126. "Contract of guarantee", "surety", "principal debtor" and "creditor" - A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor," and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written.

127. Consideration for guarantee - Anything done, or any promise made, for the benefit of the principal debtor may, be a sufficient consideration to the surety for giving the guarantee.

Illustrations

(a) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is a sufficient consideration for C's promise.

(b) A sells and delivers goods to B, C afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.

(c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void .

128. Surety's liability - The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.

Illustration

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

129. "Continuing guarantee" - A guarantee which extends to a series of transactions is called a "continuing guarantee".

Illustrations

(a) A, in consideration that B will employ C in collecting the rent of B's zamindari, promises B to be responsible, to the amount of 5,000 rupees, for the due collection and payment by C of those rents. This is a continuing guarantee.

(b) A guarantees payment to B, a tea dealer, to the amount of £100, for any tea he may from time to time supply to C. B supplies C with tea to the above value of £100, and C pays B for it. Afterwards B supplies C with tea to the value of £200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of £100.

(c) A guarantees payment to B of the price sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

130.Revoacation of continuing guarantee - A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

Illustrations

(a) A, in consideration of B's discounting, at A's bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 500 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

131.Revocation of continuing guarantee by surety's death- The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so for as regards future transactions.

132. Liability of two persons primarily liable, not affected by arrangement between them that one shall be surety on other's default — Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to sue contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence.

Illustration

A and B make a joint and several promissory note to C. A makes it, in fact as surety for B, and C, knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

133. Discharge of surety by variance in terms of contract- Any variance, made without the surety's consent, in the terms of the contract between the principal(debtor) and the creditor, discharges the surety as to transactions subsequent to the variance.

Illustrations

(a) A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

(b) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the latter Act.

(c) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by afixed salary. A is not liable for subsequent misconduct of B.

(d) A gives to C a continuing guarantee to the extent of 3,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrased and without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

(e) C contracts to lend B 5,000 rupees on the first March. A guarantees repayment C pays the 5,000 rupees to B on the first January. A is discharged from his liability, as the contract has been varied inasmuch as C might sue B for the money before the first of March.

134. Discharge of surety by release of discharge of principal debtor - The surety is discharged by any contract between the credit and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations

(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C's to assign to them his property in consideration oftheir releasing him from their demands). Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo on A's land and to deliver it to B at a fixed rate, and C guarantees A's performance of this contract. B diverts a stream of water which is necessary for irrigation of A's land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

(c) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

135. Discharge of surety when creditor compounds with, gives time to, or agrees not to sue principal debtor. A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue the principal debtor, discharges the surety, unless the surety assents to such contract.

136. Surety not discharge when agreement made with third person to give time to principal debtor - Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

Illustration

C, the holder of an overdue bill of exchange drawn by A as surety or B, and accepted by B, contracts with M to give time to B. A is not discharged.

137. Creditor's forbearance to sue does not discharge surety - Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety.

Illustration

B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

138. Release of one co-surety does not discharge others- Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.

139. Discharge of surety by creditor's act or omission impairing surety's eventual remedy - If the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

Illustrations

(a) B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

(b) C lends money to B on the security of a joint and several promissory note made in C's favour by B, and A as surety, for B, together with a bill of sale of B's furniture, which gives power to C to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realized. A is discharged from liability on the note.

(c) A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will at least once a month, see M make up the cash. B. omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

140. Rights of surety on payment or performance - Where a guarantee debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, isinvested with all the rights which the creditor had against the principal debtor.

141. Surety's right to benefit of creditor's securities- A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts, with such security, the surety is discharged to the extent of the value of the security.

Illustrations

(a) C advances to B; his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B's furniture. C cancels the mortage. B becomes insolvent , and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointây with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently C gives up the further security. A is not discharged.

142. Guarantee obtained by misrepresentation invalid - Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

143. Guarantee obtaired by concealment invalid - Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Illustrations

(a) A engages B as clerk to collect money for him. B fails to account for some of his reipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acuaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

(b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

144. Gurantee on contract that creditor shall not act on it until co-surety joins - Where a person gives a guarantee upon a contract that creditor shall not act upon it until another person has joined in it as cosurety, the guarantee is not valid if that other person does not join.

145. Implied promise to indemnify surety - In every contract of guarantee thereis an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

Illustrations

(a) B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the Bill and costs. He can recover from B the amount of the bill, but not the sums paid for costs, as there was no real ground for defending the action.

(c) A guarantees to C, to the extent of 2,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,000 rupees, but obtains from A payment of the sum of 2,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

146. Co-sureties liable to contribute equally - Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

Illustrations

(a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be repponsible to the extent of one quarter, B to the extent of one quarter, and C to the extent of one half. E makes default in payment. As between the sureties. A is liable to pay 250 rupees, B 250 rupees and C 500 rupees.

147. Liability of co-sureties bound in different sums - Co sureties who are bound in different sums are liable to pay equally as for as the limits of their respective obligations permit.

Illustrations

(a) A, B and C as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are liable to pay 10,000 rupees.

(b) A, B and C, as surities for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

APPENDIX - II

QUESTIONNAIRE AND REPLIES RECEIVED

1. Why do banks demand guarantee?
2. Is it solely on a third party guarantee or there are some other securities like pledge/ fixed deposit Account/Life Insurance Policies against which debt is granted?
3. Why do banks give guarantee?
4. Do banks arrange the guarantees?
5. Do banks explain the nature of documents?
6. Is the deed of guarantee signed before the Officer of the bank?
7. Do principal debtor execute the surety bond?
8. Do bank suggest the name of the guarantors?
9. Do banks give information to the guarantor about the financial status of the customer (principal debtor)?
10. Is guarantee a safe security for recovery of debt?
11. How for the guarantee is helpful for the business of banks?
12. How for the debts/loans have affected social economic progress?
13. Who are the beneficiaries of the loans?

i) Agriculture
ii) Industry
iii) Urban Sector
iv) Rural Sector
v) Employed
vi) Unemployed

vii) Educated
viii) Uneducated

14. How the recovery is made?
15. What is the percentage of default?
16. What are the causes of default?
17. To what extent banks have been involved in the litigation?
18. What is the reaction of the banks to the system of the guarantee?
19. How for the present law is satisfactory?
20. Any other suggestion:

Name of the bank/ Corporation.

Designation.

JAMMU & KASHMIR STATE FINANCIAL CORPORATION
SRINAGAR

1. To ensure that the borrower repays the instalments of principal and interest to the Corporation on due dates during the currency of the loan. The guarantor is a third party of suitable means who enjoys influence on the borrower for meeting debt obligations to the financial Corporation.

2. The Corporation insists on third party guarantee in every case where, however the borrower is not able to produce a guarantee of suitable means but is in a position to pledge his/her LIC policy/ fixed deposit account the same is accepted by the Corporation.

3. The SFC gives guarantee as under:

   a. Guaranteeing, on such terms and conditions as may be agreed upon:

      i. loans raised by industrial concern which are repayable within period not exceeding twenty years and are floated in the public market.

   ii. loans raised by Industrial concerns from schedule banks or state cooperative banks.

   b. guaranteeing on such terms and conditions as may be agreed upon deferred payments due from any industrial concern in connection with its purchase capital goods within India.

4. The SFC. does not arrange the guarantee for the borrower except that recommendations may be made to any bank/ financial institution for guaranteeing the arrangements of financial accommodation

depending upon the merits of the case.

5. Yes, the nature of the documents is explained to the executants be it the mortgagor or the guarantor.

6. Yes every document is executed in pursuance of the concerned officer of the SFC.

7. Yes

8. No, except that it is suggested that the guarantor should be man of substantial means enjoying reputation in the market.

9. Yes, but it is not the principal security for the reason that the guarantors meets as on effective agent between the landor and the borrower in the event of default by the borrower. That being the position the guarantor is a suitable means if not a complete security for the recovery of debt.

10. The guarantor has proved to be a quitex useful for the SFC on a majority of cases of default. The guarantors have been used as an effective tool for persuading the borrowers to meet the payment of dues forthwith.

11. The loans are being granted by Corporation to enterprenuers for setting up of industrial concerns engaged/to be engaged in various manufacturing activities. The financial assistance given by the Corporation under various schemes has definitely brought about a rapid industrialization in the state, provided means of employment

opportunity to the people and resulted a fantastic charges in the socio-economic pattern and living standard of the people. The weaker section of the population such as people below poverty lives living in far flung and rural areas have benefited from the schemes of the Corporation to a great extent. They have been provided loans upto Rs. 50,000/- per unit without margin and security for setting up of village and cottage industries. This scheme has brought living standard of the poor.

12. ~~12~~ All the sectors have benefited a great deal as ~~a~~ Corporation has granted/is providing loans to entre-prenures for setting up an industrial units/transport industry without discrimination of area/sector. However keeping in view the credit needs of different sectors. emphasis is laid on rural regional implances and employ-ment.

13. Recovery is effected by the following modes.

a. Personal pursuation with the borrowers through visits and inspections.

ii. pursuation with the help of guarantors.

iii. Letters and notices of default sent to borrower/guarantor.

iv. action u/s 29/31 of SFC's Act.

a. Taking over the management of the unit.
b. Transfer/sale of the limit.
c. Institutions of a suit against the borrower/guarantor in the Court of Law.

taking help of the banks with whom borrowers have working capital account in the matter of receiving of recovery of dues.

14. As on 31st March 1988 the % age of default to the total outstanding loan was 31.5%

15. The causes of default are catarized as under:

    i. Wilful defaulters i.e. the units are doing well but not paying the dues of the Corporation deliberately.

    ii. Non availability of raw material, lack of market.

    iii. Non availability of goods/inadequacy of working capital.

    iv. <u>Non availability of power</u>

16. As on 31st March 1988 57, units for recovery of dues were pending settlement in the court of law for an amount which forms 0.67% of the total balance outstanding loan as on 31.3.1988.

17. SFC feels that obtension of guarantee of a third party is alright so as to make the guarantor who is a person of means proposed by the borrowers himself responsible for repayment of dues by the borrower to the SFC. It gives a psychological awening to the borrower that apart from the lending institution is being pursuaded by a third person (guarantor) to need the financial obligations. The guarantor becomes legally bound to make repayment in the event of failure of the main borrower.

JAMMU AND KASHMIR BANK

1. To secure their advances. In case of default the banks invoke guarantee.
2. No . The Banks also accept other securities such as hypothication of stocks , Fixed deposits/pledge, Life Insurance Policies and mortgage of Immovable Properties.
3. To facilitate their clients to execute their contracts with other parties. This assures the person, in whose favour guarantee is issued, that the other party will execute his part of the contract.
4. Guarantors take pains usually to secure repayment of loans.
5. Yes
6. Yes - always then to be signed by Judge or Notery.
7. No - No separate bond is executed ~~xxx~~ but he assures repayment in loan agreement itself and executes a demand promisory note in favour of the Bank.
8. No - But the guarantor should have sufficient means to cover the bank advance.
9. No. But the Bank informs the guarantor the total amount of advances for which he has to give his guarantee.
10. Not always
11. It assures repayment from third person in case the principal debtor is unable to pay.

12. The Bank debt is the back bone of Indian Economy. Any plan made by the authorities is not implimented unless it is financed by banks. The loans have accelerated the growth of agriculture, expansion of Industries , self employment finally increased the percapita income of India.

13. All

14. 1. Normal recovery
 2. By sale of hypothicated good ⎫ in case of default
 3. By sale of mortgage property ⎭

15. 30 to 40%

16. 1. Wilful default, 2 Failure of crop due to natural calamities 3. Marketing problem in industrial products and 4. Under financing

17. The banks usually avoid litigation but to avoid that the securities are expired Banks are involved in litigation.

18. The guarantee helps the banks in recovery provided the guarantor is a third person and not a family member.

19. The Present law is totally ineffective . The provision must be made to authorise banks to recover the dues themselves.

THE ANANTNAG CENTRAL COOPERATIVE BANK LTD.

1. When credit facilities are given to an individual firm, corporation , banks demand various documents.In some cases mortgage of property and in some cases guarantee of respectable person is accepted. A aim of the Bank is that in case of default amount will be recovered from Guarantors

II. Not only on third party guarantee loans are being advanced but on mortgage of property hypothecation of goods or moveable property. Loansare being sanctioned against fixed deposit, other securities like pledge. However, no loan's being given against insurance policies

III. No

1v. No

5. Banks or any other financial Institutional explain the nature of documents to a loanee as well as to him guarantor,

6. Yes, the deed of guarantee is being signed before the officers of the Bank.

7. Yes

8. No, but, guarantor should be well-known to Bank and having good reputation.

9. Not in every case, but, same case were guarabtors all fail to repay the loan, one is referred to

Registrar or any other officer whom powers have been delegated.

10. Guarantee is helpful for the business of the Banker SFC but, bank has to see other aspects also before sanction of loan.

11. It is due to the Banks or other institutions that State has made progress in Agriculture, Industry and transport etc. Tourism has also made progress as house boat owners, hotel owners are being provided financial assistance.

13. i) Agriculture
    ii) Industry
    iii) Urban sector
    iv) Rural sector
    v) Un-employed (but not Employed)
    vi) Educated and
    (vii) uneducated

14. Recovery is being made as per the agreement in instalments (monthly or yearly) from the principal debtor. However, in case of default notice is issued to guarantors.

15. It is abour 40%

16. Some are wilful defaulters, some times default is due to crop faiłure , non-availability of marketing facilities. Some times due to mismanagement.

17. An amount of about 20 lakhs is involved.

18. The system of guarantee is invoage, however, hypothecation or mortgage deed is more effective for safty of advance.

Elaquiai Dehati Bank, Srinagar

1. To secure the repayment of advances.
2. The advanced can be secured by third party realisable . However where the security is realizible, like Fixed Deposits, LIC Policies etc. the advances can be greated without the guarantee.
3. The guarantee is offered by Banks on better client relations.
4. No.
5. Yes in detail also in regional language
6. Yes. It is a must
7. Yes
8. No - Borrower has to suggest himself the guarantor and they should be acceptable to Bank.
9. Yes - To educate guarantos all the details are furnished in regional language
10. Yes
11. Helpful for recovery aspects
12. To a maximum extent Bank have been successful in poverty removal thereby the society has obtained social and economic progress..
13. These are all eligible
14. Recoveries are made from the surplus amount guaranteed by the Banker from a scheme project financed by the Bank. Modes of recovery include,

personal contact with borrowers, camps organisations etc.

15. About 40%

16. Diversion of funds from the parrent scheme. Lack of job knowledge, wrong identification, wilful default , political intervention, natural calamities.

17. 5% to 10%

18. The guarantee system to a limit of Rs.10,000 has been waived of as suggested by Kelkar Committee. However personal contacts are being encouraged. This is called now social banks.

19. Not quite satisfactory

a) From borrowers point of view-

(i) the high costs are involved

(II) From Bank's point of view: 1. High casts (2) Delay in litigation (3) The Bank officers should be authorized upto a certain limit, to ~~[illegible]~~ adjudicate the suits.

20. Application of Arbitration Act and Land Revenue Act may be extended to all the Banks.

KAMRAZ RURAL BANK

1. To secure the advance
2. There are some other securities
3. Banks do not give guarantee
4. No
5. Yes
6. Yes
7. No
8. No
9. To some extent
10. If the principal debtor becomes defaulter, we can preasurise him through guarantors.
11. To a great extent
13. All are eligible except employed ones
14. We persuade the borrower for the liquidation of debt.
15. 60%
16. Loan amount is not invested for the purpose granted.
17. Very less
18. Not good
19. Very lengthy

APPENDIX - III

13th.Report of Law Commission of India

Contract Act, 1872(Relevant portion)

Secs.126-129. 105. No change is considered necessary in sections 126 to 129.

Sec.130. 106. There is divergence of opinion between some High Courts as to the right of the sureties to revoke surety bonds given to Courts. In Bai Somi v. Chokshi, which was a case of security for the guardian of a minor's estate, it was held that section 130 was inapplicable and that such a surety could not be discharged, as the very object of requiring security was to guarantee the minor's estate against the misconduct or mismanagement on the part of the guardian. In Raj Narain v. Ful Kumari, a case under the Probate and Administration Act, the surety had made an application for his discharge on the ground that the Administrator had been guilty of waste which the surety could not prevent. It was held that it was open to the Court to grant the application. In Subroya Chetti v. Ragammall, an application by the surety for an administrator for his discharge, was dismissed on the ground that no such maladministration had been proved. Thereupon the surety instituted a suit praying that the Court should discharge the plaintiff from his guarantees as a surety in regard to future transactions. The suit was dismissed upon the grounds that

(1) The making of an order for discharge might defeat the object for which an Administrator is required to find sureties to his administration bonds;

(2) Section 130 does not apply to a special contract of suretyship; and

(3) If the section applies to an administration bond, the surety could, without any action or any legal proceeding put an end to his liability by giving notice to the Registrar or to the Court.

In Kandhya Lal v. Monki the view of the Madras High Court was followed and it was held that where a person guarantees that an administrator will duly get in and administer the estate of a deceased person, there is a continuing guarantee within the meaning of sec. 129.

In our opinion the law has been correctly stated by Sulaiman, A.C.J. in In goods of Dr. Abinash Chandra, It was held in that case that although it was true that the surety cannot claim as of right to be relieved of all liability by merely expressing his intention to do so either by notice or by a proper application to the Court and, although it is also true that the case of a surety whose security has been accepted by a Court, cannot be treated as one falling under sections 129 and 130 of the Contract Act so as to entitle him to put an end to the guarantee at his will, yet that is quite a different thing from saying that the High Court itself to which the guarantee isggiven has no power to exonerate the surety from all liability for future transactions. This view is in consonance with that of the Privy Council in Mahomed Ali v. Howeson Bros. We recommend that an Exception be added to the section providing that a guarantee given to the Court cannot be revoked without the permission of the Court.

Secs.131-133. 107. No change is considered necessary in sections 131 to 133.

Sec.134. 108. There was a conflict of authority upon the question whether a surety is discharged when a creditor allows his remedy against the principal-debtor to become barred by limitation. The Bombay, Calcutta and Madras High Courts took the view that the surety is not discharged; while the Allahabad High Court had taken a different view. In Mahanth Singh v. U Ba Yi, the view of the majority of the High Courts was preferred. It was held that not every unenforceable contract was declared void, but only those 'unenforceable law', and that those words meant not unenforceable by ~~xxxx~~ reason of some procedural regulation, but unenforceable by substantive law. A mere failure to sue within the time specified by the statute of limitation or an inability to sue by reqson of the provisions of one of the Orders under Civil Procedure Code would not cause a contract to become void. It was observed that sections 134 and 139 were merely declaratory of the law in England.

We recommend that an Explanation be added to clarify this position and the view of the privy council be adopted.

109. There has been a difference of opinion between the Madras and the Nagpur High Courts as t0 the effect of Debt Relief Acts upon the liability of the surety. In cases where the creditor proves his debt but the debt is scaled down by the Board, the Madras High Court has taken the view that the surety is liable only for the reduced amount, while the Nagpur High Court has held that the surety remains liable for the whole of the original debt. In agreement with Pollock and Mulla, we prefer the opinion of the Madras High Court, which appears to be more in consonance with justice. This conflict, however, does not necessitate any change in the language of the section.

Secs.135-140. 110. No change is considered necessary in sections 135 to 140.

Sec.141. 111. This section limits the surety's right to the securities held by the creditor at the date of his becoming surety. According to the current English law "a surety has on payment and not before, a right to the benefit of all the securities, whether known to him or not at the time when he became surety, which the creditor has received from the principal-debtor, before, contemporaneously with, or after, the creation of the suretyship, and whether or not they existed at the time when the guarantee was given. We think that the law upon this point should be brought in line with the English law.

112. The section does not lay down at what point of time the surety is entitled to have the creditor's securities made over to him wholly or in part, whether at the time when the debt of the creditor is paid off or when the surety pays the amount of his guarantee. There is a difference between the Bombay and Madras High Courts on this point. In Goverdhandas v. The Bank of Bengal, a surety had guaranteed an aliquotor a defined portion of past debt secured by mortgage. On payment by him of the portion of the debt guaranteed by him, he claimed

to be entitled to share in the mortgage in proportion to the amount of the debt which he had guaranteed and paid before the mortgagee had been paid the full amount of his mortgage debt. This claim was rejected. In Parvataneni Bhushayya v. Suryanarayana, the Madras High Court doubted the correctness of this view. That Court decided that the surety was entitled to a proportionate share in a security held by the creditor at the time the surety discharged his liability even though the creditor was not fully paid. Pollock and Mulla opined that the view taken by the Madras High Court is inequitable and that the creditor's right to hold securities until the whole debt has been paid is paramount to any claim of the surety whether based upon section 140 or section 141. We agree with the opinion of the learned Commentators and recommend that it should be made clear that the surety is entitled to have the creditor's securities made over to him only when the creditor is fully paid off.

Sec. 142

113. We think that a comma should be inserted after the word 'misrepresentation', and the existing comma after the word 'creditor' removed, in order clearly to bring out that the section deals with the case of a guarantee obtained by means of misrepresentation whether the same is brought by the creditor or by some one else, with his knowledge and assent.

Sec.143 114. It has been held that this section provides for the case of a guarantee obtained by wilful silence as distinguished from mere non-disclosure. The language of the section should be brought into conformity with the judicial opinion.

Sec.144. 115. No change is necessary in section 144.

Sec.145. 116. Pollock and Mulla suggest that the words 'rightfully' and 'wrongfully' are not felicitous and that they should be substituted by the words 'reasonably' and 'unreasonably'. We do not agree. 'Rightfully' was intended to convey that the sums paid were such as the creditor was legally entitled to recover and, therefore, the surety had the right to pay, and, likewise, the expression 'wrongfully' was intended to convey that the sums paid were such as the creditor was legally not entitled to recover, and, therefore, the surety was wrong in paying the same. We feel that the expressions used by the legislature more fully convey the intended idea than the suggested expression.

117. Controversy has arisen on the question whether a surety paying a debt which is barred by limitation as against the debtor can be said to have paid it rightfully' within the meaning of this section. We

think the affirmative is the correct answer as the rights of the surety arise not from the liability of the debtor but from the discharge of his own liability. An Explanation should be added to the section to make this clear.

118. In appropriate cases the surety is entitled to recover special damages beyond the sum he has actually been compelled to pay. It has been observed that his right is not merely a right to stand in the shoes of the creditor but is founded upon an independent equity.

An Explanation should be added to the section to clearly preserve this right.

Secs.146-7. 119. No change is recommended in sections 146 to 147.

To section 130 of the Principal Act, the following

Sec.130. Ex-~~ce~~ption shall be added, namely:

"Exception- A continuing guarantee given to a court cannot be revoked by the surety as to future transactions, without the permission of the court".

Sec.134. In Section 134 of the Principal Act, the following Explanation shall be inserted at the end, namelyL "Explanation: For the purposes of this section, the following do not amount to acts or omissions the legal consequence of which is discharge of the principal debtori:-

(i) mere failure to sue the principal debtor within the time specified by any law relating to limitation for the time being in force;

(ii) inability to sue the principal debtor, arising by reason of any provision contained in any of the Orders in the First Schedule of the Code of Civil Procedure, 1908".

For section 141 of the Principal Act, the following section shall be substituted, namely:

"141. Surety's right to benefit of creditor's securities. If the debt or liability owed by the principal debtor to the creditor has been paid or discharged in fuàl, the surety is entitled to the benefit of every security which the creditor has against the principal debtor, whether such security was or was not in existence at the time when the contract of suretyship was entered into, and whether such security was received by the creditor before, contemporaneously with or after the contract of suretyship was entered into, and whether the surety knows of the existence of such security or not; and if

APPENDIX - IV

SOME SPECIMENS OF GUARANTEE DEEDS

Deed Of Guarantee

State Bank of India

....

....   Place ....

Date

In consideration of the State Bank of India (hereinafter referred to as "the Bank") having at my/our request granted/agreed to grant/continue to grant from time to time to

Shri/Smt. ....

Son of/wife of/daughter of

....

Address ....

Smri/Smt ....

Son of/wife of/daughter of

....

Address ....

....

Shri/Smt. ....

Son of/wife of/daughter of

....

Address ....

....

Shri/Smt ....

Son of/wife of/daughter of
....

Address
....

....

here enter name(s) of individual borrower/co-owner borrowers

OR

If the bdrrower is other than
individual/co-owners, the
norrower is to be described
here in accordance with the
constitution of the borrower
as per the Administrative
Instruction No. ....

Who are carrying on the business of farming/rearing of cattle $\frac{\text{and}}{\text{or}}$ flock/fishing sericulture (hereinafter referred to as "the borrower(s)")

(1) Cash Credits at any one time upto
the limit of Rs. .... Rupees only

(2) Overdraft at any one time to the
extent of Rs. .... Rupees only

(3) Demand Loans at any one time for Rs. ....
....Rupees only

the creditor loses or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security".

Sec.142. In section 142 of the principal Act -

(a) a comma shall be inserted after the word "misrepresentation";

(b) the comma appearing after the word "creditor" shall be omitted.

Sec.143. In section 143 of the principal Act, for the words "by means of keeping silence" the words "by wilful silence" shall be substituted.

Sec.145. To section 145 of the principal Act, the following Explanations shall be added, namely:

Explanation 1- The right of the surety to indemnity under this section shall not be deemed to prejudice his right to recover damages in appropriate cases.

Explantion 2 - Payment by a surety of a debt barred as against the principal debtor by limitation, is a payment made "rightfully" within the meaning of this section".

(4) Term Loans at any one time of Rs.................(Rupees only)

(hereinafter collectively and individually referred to as "the loans")

I/We ....

Son of/daughter of/wife of ....

Address ....

Son of/daughter of ....

Address ....

Son of/daughter of/wife of ....

Address ....

Son of/daughter of/
wife of ....

Address ....

hereby guarantee repayment of all moneys payable by the Borrower(s) to the Bank in respect of the loans together with interest thereon and all costs and expenses and the performance by the borrower(s) of the terms of the loans and I/we also agree to pay and make good to the Bank on demand all losses,costs, demages and expenses occasioned to the Bank by reason of non-payment or the breach of any of the terms aforesaid subject to the terms and conditions hereinafter contained;

compound or make any other arrangement with the borrower(s) without releasing or discharging me/us and/or in any manner affecting my/our liability under the guarantee. In the event of any such variation or composition or agreement I/we shall be deemed to become liable hereunder in all respects including such variation composition or arrangement.

4. That the guarantee hereby given is independent and distinct from any security that the Bank has stipulated to take or has taken or may take in any manner whatsoever shall have been fully satisfied. And further that notwithstanding the provisions of sections 140 and 141 of the Contract Act 1872, or any other provisions of ~~sections~~ that Act or any other law, I/we will not claim to be discharged on account of the Bank's failure to take any security or for losing for any reason whatsoever including reasons attributable to Bank's default and negligence and to the operation of law any such security.

5. That without prejudice to the effect in any manner whatsoever of the foregoing clause, the Bank's failure in requiring performance of any of the terms contained in any Agreement(s) or letter(s) and the default of the Bank in enforcing the performance of any of the terms shall not have the effect of releasing me/us from my/our liability.

6. That if the Borrower(s) shall become insolvent, enter into liquidation (compulsory or voluntary) or make any arrangement or composition with creditors, the Bank (notwithstanding payment to the Bank by me/us or any other person of the whole or any part of the amount hereby secured/shall rank as creditor and prove against the estate of the Borrower(s) for the full amount of the Bank's claims against the(Borrower(s or agree toand accept any composition in respect thereof and the Bank may receive and retain the whole of the dividends, compensation or other payments thereof to the exclusion of all my/our rights as guarantor(s) in competition with the Bank until all the Bank's claims are fully satisfied and I/we will not by paying off the amount payable by me/us or any part thereof or otherwise prove or claim against the estate of the Borrowers until the whole of the Bank's claim against the Borrower(s), in respect of all the liabilities whatsoever, have been satisfied and the Bank may enforce and recover payment from me/us of the full amount payable by me/us notwithstanding any such proof or composition as aforesaid.

7. That in the case of Borrowers being a firm(s) my/our guarantee and obligations hereunder shall not be affected by any change in the constitution of such firm(s) whether consisting of or reduced to one individual at any time and in the case of our being a firm, our firm and all members from time to time thereof shall be bound hereby notwithstanding any change in the constitution of our firm whether consisting of or reduced to one individual at anytime and being more than one individual all of us shall be bound jointly and severally. We further agree that in the event of our being more than one individual unconnected in partnership notwithstanding anything hereinbefore contained we shall be jointly and severally liable to the Bank for the entire outstanding in respect of the loans.

8. That the Guarantor hereby gives his consent for the amount under this guarantee being recovered as a public demand/moneys in terms of any legislation relating to recoveries thereof, where such consent is required under such legislation.

Here enter
the name of
language.

The contents of the Deed have been read over and translated into .... and explained to the Guarantor(s) and he/they having understood the contents thereof subscribe(s) to these presents.

Signed and delivered by the said

Shri .... (Guarantor)

Shri .... (Guarantor)

Shri .... (Guarantor)

Shri .... (Guarantor)

DEED OF GUARANTEE

This deed of guarantee is executed this the ..... day of .... at Srinagar, between .... Son of .... R/o .... (hereinafter referred to as the guarantors) which expression shall be deemed to mean and include their heirs, executors, administrators, representatives and nominees etc, in favour of the Jammu and Kashmir Bank Limited having its Registered Office at Residency Road Srinagar and a branch office at Nallamar Road Srinagar (hereinafter referred to as the Bank) which expression shall unless repugnant to the context thereof be deemed to include its assigns and nominees and successors in interest.

Whereas the Bank has sanctioned an advance facility to the extent of Rs. /- (Rupees) in favour of ....S/o............. R/o..................................(hereinafter called the borrower) against the security of the hypothecation of stocks of allkinds of Kiryana goods etc:

Whereas the said advance facility granted in favour of the borrower is intended to be further secured by the personal guarantee of the above said guarantors and

Whereas the said guarantors have in accordance with the terms and conditions of the Bank's requirement agreed to execute this deed of guarantee in favour of the Bank as security for the credit facility allowed to the borrower.

NOW THIS DEED WITNESSETH AS UNDER

1. That in consideration of the Bank having agreed to sanction loan to the extent of Rs. /(Rupees) in favour of the borrower the receipt whereof shall be acknowledged by the said borrower at the time of execution of the documents and or withdrawal of money by him from the Bank, the Guarantors hereby guarantee to the Bank the full repayment of all the moneys including the principal money, the interest thereon at the ruling rate andoother charges charged by the Bank on these accounts in the course ofits business as bankers which shall at any time be due to you from the said borrower towards the Bank on his respective account with the Bank or any other account, whatsoever when the same shall be owing and become payable by the said borrower to the Bank until the entire dues in the borrower's said respective account with the Bank within this branch at Nallamar Road,Srinagar is fully liquidated and the borrower discharged from any liability whatsoever to the Bank as such.

2. That the guarantee shall be without any prejudice to any security/ies which the Bank may now or hereafter have from the borrower or from any one else in respect of any indebtedness or liabilities.

3. That the guarantee shall be continuing guarantee and shall not be considered as wholly or partially satisfied or exhausted by any payments from time to time. The guarantee shall also continue to remain in force from time to time notwithstanding the discharge of the borrower by operations of law.

4. That the Bank shall have the full discretionery without any assent or knowledge of the guarantors to negotiate with the borrower and settle and or alter the terms and conditions of the loan to compromise, to grant time and indulgence or to sue the borrower or compound or make any other arrangement with the borrower as the Bank may think fit and to hold over, revive, vary, exchange, or release in whole or part any security held by the Bank as security for or on account of the moneys or part thereof. The guarantor further agree that it shall not be discharged from liability by the Bank's releasing the borrower. It is also agreed that the Guarantors shall not be entitled to any of the rights conferred as sureties by sections 133,134, 135 and 141 of the Contract Act.

5. That the Bank may recover against the Guarantors notwithstanding that any securities given or to be given to the Bank may be void, defective or that the borrower has exceeded its powers or that the

arrangements of the borrower with the Bank are ultravires and without being bound to enforce its claim, the Bank shall not be bound to enquire into the powers of the borrower and all moneys due and liabilities incurred shall be deemed to form part of the present guarantee.

6. That in case default shall be made in the payment of the borrower to the Bank or any lawful claim or demand held by Bank against the borrower, the guarantee hereby covenents, promises, and agrees to pay the same to the Bank, its successors and assigns on demand.

7. That the Guarantors further agree that with respect to its liability hereunder, the Bank shall have a lien on all secutities belonging to the Guarantors now or hereafter standing belonging to the Guarantors now or hereafter standing to the credit with the Bank on any account.

8. That any account settled by or started between the Bank and the borrower or admitted by the borrower shall be concepted by the guarantors as conclusive evidence. A certificate in writing signed by an officer of the Bank standing the balance on any particular date payable under this deed of guarantee shall be conclusive evidence against the Guarantor

9. That notwithstanding any meaning or import or otherwise in any clause therefore this guarantee shall be full complete and perfect and continuing one shall remain in force and the said above named Guarantors till the loan secured under this guarantee is fully adjusted and alongwith the interest thereon and also the changes that are incurred by the Bank and the accounts of the borrower closed in the books of the Bank.

10. That the Bank shall be free to invoke the guarantee and the Guarantors undertake to pay the amount to the Bank secured under this guarantee within seven days from the date of receipt of demand in writing from the Bank.

11. That this guarantee shall be enforceable notwithstanding any change in the name of the Bank. It shall ensure for the benefit of any banking company with the Bank shall assign itself to.

12. That if the borrower shall at any time be found not to be liable to the Bank under any law in force for the advance/s made or credit/s given by the Bank to the borrower by reasons of its incapacity to the borrower to contract or for any other reasons, the Guarantors shall nevertheless be liable on the principal debutors pay to the Bank all sums that would have been recoverable by the Bank from the borrower and this guarantee shall

be construed accordingly the consideration for the giving of which shall be the keeping of the composite term loan account in the name of the borrower and permitting such accounts to be over-drawn or the pending payments or advancements of moneys to for on on an account of or apparantly for the purpose of the debutor as the case may require.

13. That the Guarantors declare that it has not received any security from the borrower from giving this guarantee and agree that it shall not, so long as any money remain owing by the borrower to the Bank or any liability incurred by the Bank remain outstanding, take any security in respect of its liabilities, hereunder without first obtaining the Bank's consent in writing.

14. That a demand in writing shall be deemed to have been duly made to the Guarantors if sent by post under registered cover and shall be deemed to have been received by the said Guarantors six days after posting thereof and shall be sufficient if signed by an officer of the Bank and in proving that the letter containing the demand was properly addressed and send under registered cover.

In witness whereof the parties mentioned above have signed this deed of guarantee on the date and place first above written in presence of:

Witnesses :

1.......................

S/o..................

R/o ....

2. ....

S/o ....

R/o ....

DEED OF GUARANTEE

This Indenture made the__________________ day of______ _________ One thousand nine hundred and eighty___________ _________ between ______________________________________ ____ ____

hereinafter called "THE GUARANTOR/S" (which expression shall unless repugnant to the context or meaning thereof be deemed to include his/their respective heirs, successors, executors, and administrators) of the one part and the JAMMU AND KASHMIR BANK LIMITED (a joint stock company incorporated under the Jammu and Kashmir Companies Act No. XI of 1977 and having its registered office at Srinagar hereinafter called "The Bank (which expression shall unless repugnant to the context or meaning thereof be deemed to include its assigns) of this other part.

Whereas this deed is intended to be supplemental to the Deed of Hypothecation/hereinafter called "the deed of hypothecation" dated___________________ and made between____ (hereinafter called "the Borrower") of the one part and the Bank of the other part being deed of hypothecation of the vehicle bearing Engine No._________ Chassis No.___________ and Registration No.___________ referred to therein to secure repayment to the Bank of the principal sum of Rs. ______________ with interest hereon at the rate therein mentioned;

And whereas the Bank agreed to lend the said sum of Rs.___________ to the borrower at their request and upon the terms that the guarantor/s should give to the Bank such guarantee as hereinafter appears. Now this Indenture Witnesseth and it is hereby convenanted as agreed (the guarantor/s contracting jointly and severally) as follows:-

1. If at any time default shall be made in the payment of the instalment of principal and/or interest and/ or any other money's for the time being due to the Bank upon the security of the hypothecation of the vehicle and guarantor/s will pay the Bank the whole of such principal, interest and other moneys which shall then be due to the Bank as aforesaid and will Indemnify and keep indemnified the Bank against all loss of principal, interest or the moneys secured by the hypothecation and all costs, charges and expenses whatever which the Bank may incur by reason of any default on the part of the borrower, its successors or on assigns.
2. The Bank shall have the fulless liberty without affecting this guarantee to postpone for any time or from time to time the exercise of the power of sale

or any other power or powers conferred by the Deed of Hypothecation and to exercise the same at any time and in any manner and either to enforce or forbear to enforce covenants for payment of principal or interest or any other covenants contained or implied in the Deed of Hypothecation or any other remedies or securities available to the Bank and the Guarantor/s shall not be released by any exercise by the Bank of its liability with reference to the matters aforesaid or any of them or by reason of time being given to the borrower, its successors or assigns of any other forbearance act, on ommission on the part of the Bank or any other indulgence by the Bank to the borrower or by any other matter or thing whatsoever which under the law Relating to sureties would but for this provision have the effect of so releasing the Guarantor/s.

3. The Guarantor/s will observe and perform all the terms, conditions and covenants contained in the Deed of Hypothecation in such manner in which the borrower is liable for the due observance and performance of the said terms, conditions and covenants.

4. The guarantee herein contained shall be enforceable against the Guarantor/s notwithstanding the securities specified in the Deed of Hypothecation or any of them at the time when proceedings are taken against the Guarantors hereunder be outstanding or realised.

5. In order to give effect to the guarantee herein contained the Bank shall be entitled to act as if the Guarantor/s was/were the principal debtor/s to the Bank for all payments and covenants guaranteed by him/them as aforesaid to the Bank.

6. The guarantee contained in this Deed is a continuing one for all amount advanced on hereafter to be advanced by the Bank to the borrower under the Deed of Hypothecation as also for all interest, costs and other moneys which may from time to time become due and remain unpaid to the Bank thereunder.

7. The guarantee herein contained shall not be determined or affected by the death of any one or more of the Guarantors but shall in all respects and for all purposes be binding and operative until, repayment of all moneys due to the Bank as aforesaid.

8. The guarantee herein contained shall not be determined or in any way prejudiced by any absorption of or by the Bank or any amalgamation thereof or therewith but shall ensure and be available for and by the absorbing or amalgamated Bank or concern.

In witness whereof the Guarantor/s have hereunto set his/their respective hands the day and year first above written.

Signed by the above named,

Witness:

1.

2.

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THE JAMMU AND KASHMIR BANK LTD.

Hypothecation of goods to secure a Demand Cash Credit/Overdrafts.

No.______________

Amount Rs.__________

Name:

The Jammu and Kashmir Bank Ltd., (hereinafter called "The Bank") having at the request of____________ (hereinafter called the borrowers) opened or agreed to open in the books of the Bank at _____________ a cash credit/overdraft account to the extent of Rupees________ _________ with the borrowers to remain in the force until closed by the Bank and to be secured by goods to be hypothecated with the Bank it is hereby agreed between the Bank and the borrowers (the borrowers agreeing jointly and severally) as follows:

1. The borrowers hereby hypothecate in favour of the Bank the goods described in general terms in the schedule (hereinafter referred to as the 'hypothecated goods') which expression shall include all products, goods and movable property of any kinf belonging to the borrowers which now or hereinafter from time to time during this security shall be brought in, stored or be in or about the borrowers' premises or godowns at _____________________ or wherever else the same may be as security for the

payment by the borrowers to the Bank of the balance due to the Bank at any time or ultimately on the closing of the said cash credit/overdraft account and for the payment of all debts and liabilities mentioned in the 13th class hereof. The expression 'the balance due to the Bank' in this and the subsequent clauses of this Agreement shall be taken to include the principal moneys from time to time due on the said cash credit/overdraft account and also all interest thereon calculated from day to day at the rate hereinafter mentioned and the amount of all charges and expenses which the Bank may have paid or incurred in any way in connection with the hypothecated goods or the sale or disposal thereof in covering any type of insurance risk thereon including fire, burglary and riot and civil commotion risks.

2. That the hypothecated goods and all sales, realization and insurance proceeds thereof shall be held as the Bank's exclusive property specially appropriated to this security and the borrowers will not create any mortgage, charge or lien or encumbrance affecting the same or any part thereof nor do anything which would prejudice this security and the borrowers shall not part with the hypothecated goods save by way by way of sale in the ordinary course of the borrowers business and as hereinafter provided nor shall any sale be made after prohibition

in writing from the Bank against selling.

3. That the borrowers shall with the previous consent of the Bank be at liberty from time to time to sell or dispose of in any manner the hypothecated goods or any part thereof provided the advanced value of such goods is paid into the said account or goods of a similar nature to those mentioned in the schedule hereto or any of the same and of at least equal value, are substituted for the goods so sold or disposed of after approval of the Bank obtained in writing.

4. The borrowers shall permit the Bank, their agents and servants from time to time and at all times to enter upon any godown or premises wherein the hypothecated goods or any part thereof may for the time being be and to view, inspect and value the same and take inventories thereof and render to the Bank and their servants all facilities as may be required for any of the purposes aforesaid.

5. The borrowers shall punctually pay all rents, rates and taxes and other outgoings of the godowns and premises wherein the hypothecated goods shall be stored and keep the same free from distress.

6. That the hypothecated goods shall be insured against fire risk by the borrowers in some insurance office or offices approved by the Bank and in the name and for the sole benefit of the Bank fortheir full market value and the borrowers will on demand deliver to the Bank all policies for the receipts for permia paid on such insurance endorsed and assigned with the full benefit thereof in favour of the Bank. Should the borrowers fail to so insure or fail to deliver the policies or receipts for premia duly endorsed as aforesaid three days after demand the Bank shall be at liberty though not bound to effect such insurance at the expense of the borrowers. The borrowers further agree that the Bank shall be at liberty at any time at its discretion (without being bond to do so) to insure the securities for their full market value against riot and civil commotion risk or any other type of insurance risk at the expenses of the borrowers with any insurance company.

7. That all sums received under any such insurances as aforesaid shall be applied in or towards the liquidation of the balance due to the Bank for the time being and in the event of their being a surplus the same shall be applied as provided by the 13th clause hereof.

8. That the borrowers shall make and furnish to the Bank all statements and returns of the cost and market value of the hypothecated goods and a full description thereof and produce such evidence in support thereof as the Bank may from time to time require and shall maintain in favour of the Bank a margin of________ percent between the market value from time to time of the hypothecated goods and the balance due to the Bank for the time being. Such margin shall be calculated on the open market value of the hypothecated goods as fixed by the Bank from time to time and shall be maintained by the borrowers either by the hypothecation of further goods to be approved by the Bank in writing or by cash payment by the borrowers immediately on the market value for the time being of the hypothecated goods becoming less than the aggregate of the balance due to the Bank plus the amount of the margin as calculated above.

9 That interest at the rate of_______ percent above Reserve Bank of India rate subject to a minimum rate of _______ percent per annum with monthly rests shall be calculated and charged on the daily balance in the Bank's favour due upon the said cash credit/overdraft account until the same is fully liquidated and shall be paid by the borrowers as and when demanded by the Bank.

10. That on demand by the Bank the borrowers shall pay to the Bank the balance them due to the Bank on the said cash credit/overdraft account together with all further interest at the rate above mentioned and the amount of all further charges and expenses (if any) to the date of payment provided that nothing herein this clause contained shall be deemed to prevent the Bank from demanding payment of the interest for the time being due at the above mentioned rate without at the same time demanding payment of the balance due to the Bank exclusive of such interest.

11. In default of payment by the borrowers in terms of these presents or in the event of the borrowers committing a breach of any of the terms and conditions of these presents, the Bank and their officers and agents shall be entitled without notice to the borrowers but at the borrower's risk and expenses and if so required as attorneys for and in the name of the borrowers to enter and remain at any place where the hypothecated shall be and to take possessions of, recover and receive the same and/or appoint any officer of the Bank as receiver or receivers of the hypothecated goods and/or sell by public auction or by private contract or otherwise

dispose of or deal with all or any part of the hypothecated goods and to enforce, realise, settle, compromise and deal with any of the rights aforesaid without being bound to exercise and of these powers or being liable for and less in the exercise thereof and without prejudice to the Bank's right and remedies of suit against the borrowers and to apply the net proceeds of such sale in or towards liquidation of the balance due to the Bank and the borrowers hereby agree to acdept the Bank's account sales of realisation and to pay any sort fall or deficiency shown therein.

12. That if the net sum realised by such sale be insufficient to oover the balance then due to the Bank, the Bank shall be at liberty to apply any other money or moneys in the hands of the Bank standing to the credit of or belonging toxthe borrowers or any one or more of them in or towards payment of the balance for the time being due to the Bank and in the event of their not being any such money or moneys as aforesaid in the hands of the Bank or in the event of such money or moneys being still insufficient for the discharge in full of such balance the borrowers promise and agree forthwith on production to them of an account to be prepared and signed as in the 14th clause hereinafter provided to pay further balance which may appear to be due by the borrowers thereon . PROVIDED ALWAYS that nothing herein

contained shall be deemed to hegative, qualify or otherwise prejudicially effect the right of the Bank (which it is hereby expressly agreed the Bank shall have) to recover from the borrowers the balance for the time being remaining due from the borrowers to the Bank upon the said cash credit/overdraft account notwitstanding that all or any of the said hypothecated goods may not have been realized.

13. That in the event of there being a surplus available of the net proceeds of such sale after payment in full of the balance due to the Bank it shall be lawful for the Bank to retain and apply the said surplus together with any other money or moneys belonging to the borrowers or any one or more of them for the time being in the hands of the Bank in or under whatever account as for as the same shall extend against, in or towards payments or liquidation of any and all other moneys which shall be or may become due from the borrowers or any one or more of them whether solely or jointly with any other person or persons, firm or company to the Bank by way of loans, discounted bills, letters of credit, Guarantees, charges or of any other debt or liability including Bills, Notes , credits and other obligations current though not then due or payable

or any other demands legal or equitable which the Bank may have against the borrowers or any one or more of them or which the law of setoff of mutual credit would in any case admit and whether the borrowers or any one or more of them shall become or be adjudicated, bankrupt or insolvent or be in liquidation or otherwise and interest hereon from the date on which any and all advance or advances in respect thereof shall have been made at the rate of respective rates at which the same shall have been so advanced.

14. The borrowers agree to accept as conclusive proof of the correctness of any sum claimed to be due from them to the Bank under this agreement a statement of account made our from the books of the Bank and signed by the Accountant or other duly authorised officer of the Bank without the production of any other voucher, document or paper.

15. That this agreement is to operate as security for the balance from time to time due to the Bank and also for the ultimate balance to become due on the said cash/overdraft account and the said account is not to be considered to be closed for the purpose of this security and the security of hypothecated goods

is not to be considered exhausted by reason of the said cash credit/overdraft account being brought to credit at any time or from time to time or of its being drawn upon to the full extent of the said sum of Rs. __________ if afterwards reopened by a payment to credit.

16. The borrowers hereby declare that all the hypothecated goods are the absolute property of the borrowers at the sole disposal of the borrowers and free from any prior charge or encumbrance and that all future goods and property hereunder shall be likewise their unencumbered, undisposed property and that the borrowers have not done or knowingly suffered or been party or privy to anything whereby they are in anywise prevented from hypothecating the hypothecated goods in manner aforesaid and that the borrowers will do and execute at their costs all such acts and things for further and more particularly assuring the hypothecated goods are any part thereof to the Bank as shall be required by the Bank and for giving better effect to these presents the borrowers authorise and irrevocably appoint the Bank and/or their officers as attorneys and attorney for and in the name of the

borrowers to act on behalf of the borrowers and to execute and do any act, assurance and things which the borrowers ought to execute and do under these presents are generally to use the name of the borrowers in the exercise of the powers hereby conferred.

17. Provided always that this agreement is not to prejudice the rights or remedies of the Bank against the borrowers irrespective and independent of this agreement in respect of any other advances made or to be made by the Bank to the borrowers.

18. In case the borrowers shall be a firm or members of a firm no change whatsoever in the constitution of such firm,during the continuance of this agreement, shall impair or discharge the liability of the borrowers or any one or more of them thereunder.

19. The borrowers hereby agree and undertake to compły with all the provisions of the various control orders already promulgated or that may be promulgated hereafter by the Government and shall see that the Bank's interest are not in any way affected or prejudiced by infringing the provisions thereof. The borrowers hereby agree to liquidate the stocks in terms of Control orders or any other orders or instructions from Government.

20. The borrowers shall submit the declaration in respect of stocks held by them as and when required and the form and manner prescribed by the Government in the various Control orders and will hand over the declaration as regards the stocks so hypothecated.

In witness whereof the borrowers have hereunto set their hands this __________day of___________ one thousand nine hundred and

Place

Date

LETTER OF GUARANTEE

Place...........

Date ....

The Manager,
THE JAMMU & KASHMIR BANK LTD.
...............BRANCH

Dear Sir,

In consideration of your bank at my/our request allowing an accommodation by way of demand loan to _ __________ at______________ branch, I/We jointly and severally guarantee to you the repayment on demand in writing of all moneys interest and other charges which may at any time be due to you from the said......

2. This guarantee shall be a continuing guarantee and will remain operative and in full effect in my/our liability as guarantor is satisfied.

a) You may grant time and other indulgence and/or enter into any settlement or compromise with the said................ This guarantee will not be cleared insolvent.

b) My/Our liability as guarantor will remain unaffected even if the said .... may enter into any composition with his creditors or even if he may declared insolvent.

c) This guarantee shall not be affected by my death/ by the death of any of us but shall remain in force until the amount to due the bank is repaid in full.

d) You may accept any security or part with the same or sell the same without notice to me/us/ my/our liability as guarantor shall remain un-affected in any such event.

4. Any account settled by and between you and the said..............or admitted by him, will be conclusive evidence of the amount outstanding in his account against me/us. The said................ is authorised to acknowledge my/our liability as guarantor at any time during the currency of the account.

5. That the bank shall be entitled to proceed against me/us for the recovery of its dues outstanding against the said .... without proceeding against him or exhausting any of the securities that may at any time be held by the bank in the account.

Yours faithfully,

Signature.............
Full name (
Address...............

THE JAMMU AND KASHMIR BANK LIMITED

Residency Road, Srinagar

PERSONAL STATEMENT OF THE GUARANTOR

1. Name:
2. Father's name:
3. Cast:
4. Occupation:
5. How long:
6. Age:
7. Whether Married:
8. Monthly Income:
9. Permanent Private Address:
10. Business Address:
11. Post Office:
12. Telegraph Office:
13. Description of house property owned:
14. Situation of property:
15. Landed property owned:
16. Its Location:
17. State if encumbered:
18. Moveable property owned:
19. Business investment:
20. Your title to the above:
21. Market value of the property:
    - a) House value of the property:
    - b) Landed property:
    - b) Other assets:

22. Have you any vehicle on hire system of guaranteed any:

23. Are you willing to stand a guarantor of:

24. Motive underlying guarantee:

25. Relationship with the borrower:

26. Have you understood your responsibility as a guarantor in this case:

27. Give two respectable references with their Address:

1. 2.

I hereby declare that the above statements are true and they will form the basis of my contract with you and if they turn to be false I hold myself criminally liable.

Dated............ Signature of the Guarantor

CONFIDENTIAL REPORT ON THE GUARANTOR IN THE CASE OF DURABLE CONSUMER LOAN

1. Name
2. Address:
   a) Official
   b) Residential
3. Occupation:
   a) Service
      Indicate the name of the institution where employed, Temporary/Permanent.

   b) Business

      Nature and location of business

4. Monthly income: Rs.
   In the case of an emplyee (attach pay certificate of the institution) In the case of person engaged in business state market reputation and monthly income from his business.
5. Age
6. Details of assets of the guarantor by way of movable/ immovable property:
7. Other assets, if any

8.	Whether the guarantor is a debtor to the Bank at its any branch:	Yes/No.
9.	Type of deposit with the branch and date since when dealing with the branch:	Saving/Fixed/Current
10.	Estimated worth of the guarantor	Rs.
11.	Whether the person is fit to be a guarantor:	Yes/No.

Manager

CONFIDENTIAL REPORT ON THE GUARANTOR
IN THE CASE OF DURABLE CONSUMER LOAN

1. Name

2. Address:

   a) Official

   b) Residential

3. Occupation:

   a) Service

      Indicate the name of the Institution where employed, Temporary/Permanent

   b) Business

      Nature and location of business

4. Monthly income: Rs.

   In the case of an employee (attach pay certificate of the institution)

   In the case of person engaged in business state market reputation and monthly income from his business.

5. Age

6. Details of assets of the guarantor by way of movable / immovable property:

- XXXX -

7. Other assets, if any

8. Whether the guarantor is a debtor to the Bank at its any branch: Yes/No

9. Type of deposit with the branch and date since when dealing with the branch: Saving's/Fixed/Current

10. Estimated worth of the guarantor Rs.

11. Whether the person is fit to be a guarantor Yes/No.

Manager

Made on__________ between ____________ S/o_____________

R/o ________________ herein after called as the employee of J.& K. State Industrial Development Corporation Ltd. Srinagar. Herein after called SIDCO Whereas the employee has applied for the post of_______ in the scale of _________. Now this agreement witnesses as under:

1. That the employee shall not give up the service at any time during the period of 5 years during which period the employee shall not seek employee outside the Corporation.

2. That the employee shall not give up the service at any time during the period of 5 years and in case of breach of this condition the employees shall repay to SIDCO all expenses incurred on the employee in connection with training, if any, tour and imparting technical knowledge if any, and in addition a penalty upto 5000/- at the discretion of the SIDCO.

3. That the employee shall not give up half way training if any, for which , the employee may be deputed during the period.

4. That the employee shall beyond to serve SIDCO on completion of any braining during the period.

5. That employee will faithfully, obidently discharge the duties imposed upon him during the course of his employment and shall not be guilty of any misconduct.

6. *That in case of any each of abòve conditions* the employee will be liable to be dismissed and the employee shall be bound to compensate the SIDCO for any loss caused to the later on account of the said brreach and early termination of this agreement.

7. That the employee will not hold the SIDCO for injury caused to him on account of an accident or mischeap arising out of negligence act for omission of any hi co-employee.

8. The employee will have no objection in case the factory is put in the private sector or joint sector and under such circumstances the employee will continue to work in the factory for a minimum period as per the stipulation of the agreement.

9. That the employee shall be entitled to one months notice in case his work is not found satisfactory if he is discharged wrongly he shall be entitled to one month pay in lieu of the notice period.

In witness were of the parties aforementioned have signed this deed in token of acceptance thereof.

Witness:

1. ______________

2. ______________

<u>EMPLOYEE</u>.

DEED OF GUARANTEE

This indenture made the day of one thousand nine hundred and eighty six between ___________ hereinafter called the Guaranters (which expression shall unless repugnant to the context or meaning thereof be deemed to include their respective heirs, executors and administrators of the one part and the Jammu and Kashmir State Financial Corporation, a Corporation established by the State Financial Corporations Act, 1951, and having its head office in Srinagar/Jammu hereinafter called the Corporation (which expression shall unless repugnant to the context or meaning thereof be deemed to include its successors and assigns) of the other part.

Whereas this deed is intended to be supplemental to a mortgage/hypothecation (hereinafter called the hypothecation/ mortgage bearing even date herewith and made between M/s ___________ hereinafter called the concern/firm/company of the one part and the Corporation of the other part being a mortgage/hypothecation of the lease hold rights in land hereditaments and premises and the machinery plant and fixtures referred to therein to secure the repayment to the Corporation of the Principal sum of Rs.________ (rupees ___________).

with interest at the rate therein mentioned and whereas the Corporation agreed to lend the said sum of Rs._________ (rupees _________

____

to the concern/firm/company at the request of the guarantors and upon the terms that the guarantors should give to the Corporation such guarantee as hereinafter appears. Now this indenture witnesseth and it is hereby covenated and agreed (the guarantors contracting jointly and severally) as follows:

1. If at any time default shall be made in the repayment of principal interest or any other moneys the time being due to the Corporation upon the security of the hypothecation/mortgage and guarantors will pay to the Corporation the whole of such principal interest and other moneys which shall them be due to the Corporation against all loss of principal interest or other moneys secured by the hypothecation/mortgage and all costs charges and expenses whatsoever which the Corporation may incur by reason of any default on the part of the concern/firm/company its successors or assigns.

2. The Corporation shallhave the fullest liberty without affecting this guarantee to postpone for any time or from time to time the exercise of the power of sale or any other power or powers conferred by the

hypothecation/mortgage and to exercise the same at any time and in any manner and either to enforce or forbear to enforce the covenants for payment of principal or interest or any other covenants contained or implied in the hypothecation/mortgage or any other remedies or securities available to the Corporation and the guaranters shall not be released by the exercise by the Corporation of its liability with reference to the matters aforesaid or any of them or by reason of time being given to the concern/firm/company its successors or assigns or any other forbearance act or ommission on the part of the Corporation or any other indulgence by the Corporation to the concern/firm/company or by any other matter or thing whatsoever which under the law relating to sureties would but for this provision have the effect of so releasing the guarantors.

3. The guarantors will observe and perform all the terms and conditions and covenants contained in the mortgage/hypothecation in such manner in which the concern/firm/company is liable for the due observance and performances of the said terms and conditions and covenants.

4. The guarantee herein contained shall be enforceabl against the guarantors notwithstanding the securities

specified in the hypothecation/mortgage or any of them shall at the time when proceedings are taken against the guarantors hereunder be outstanding or unrealised.

5. In order to give effect to the guarantee herein contained the Corporation shall be entitled to act as if the guarantors were the principal debtors to the Corporation for all payments and covenants guaranteed by them as aforesaid to the Corporation.

6. The guarantee contained in this deed is a continuing one for all amounts advanced or to be hereafter advanced by the Corporation to the firm/concern/company under the mortgage hypothecation deed as also for all interest costs and other moneys which may from time to time be due and remain unpaid to the Corporation hereunder.

7. The guarantee herein contained shall not be determined or effecting by the death of any one or more of the guarantors but shall in all respects and for all purposes be binding and operative until repayment of all moneys due to the Corporation aforesaid.

8. The guarantee herein contained shall not be determined or effected by any absorption of or by the Corpo-ration amalgamation thereof or therewith but shall ensure and be available for and by the absorbing or amalgamated Corporation or concern.

Witnessess Signed by the above named

1.

2.

SURETY BOND

Whereas a loan of Rs.______________ has been granted to Shri________________S/o.__________ R/o________________ working at present as ___________ by the University of Kashmir on the condition that the borrower shall enter into an agreement with the Registrar, University of Kashmir and further that the borrower shall furnish a surety.

Whereas the said Borrower has entered into an agreement with the Registrar,University of Kashmir, I stand surety for the said Borrower and bind myself, successor, in interest as under:

That in case of the Borrower making default in payment of the said loan or any interest thereon as agreed upon by him or in fulfilling any of the conditions on which the loan has been granted to him, I shall be liable for the repayment of the full amount with interest due from the Borrower to the University of Kashmir.

Date____________ Day of__________

Witness

1.

2.

Signature of Surety
Designation
Adress